IN THE SUPREME COURT OF NEW ZEALAND SC 135/2016

BETWEEN	**ERIC MESERVE HOUGHTON** Appellant
AND	**TIMOTHY ERNEST CORBETT SAUNDERS** **SAMUEL JOHN MAGILL** **JOHN MICHAEL FEENEY** **CRAIG EDGEWORTH HORROCKS** **PETER DAVID HUNTER** **PETER THOMAS** **JOAN WITHERS** First Respondents
	CREDIT SUISSE PRIVATE EQUITY INC Second Respondent
	CREDIT SUISSE FIRST BOSTON ASIAN MERCHANT PARTNERS LP Third Respondent
	FIRST NEW ZEALAND CAPITAL Fourth Respondent
	FORSYTH BARR LIMITED Fifth Respondent
Hearing:	5 September 2017
Coram:	Elias CJ Glazebrook J O'Regan J Arnold J Kós J
Appearances:	C R Carruthers QC, P A B Mills and G R Abdale-Weir for Appellant

A R Galbraith QC and D J Cooper for the First Respondents Saunders, Feeney, Horrocks, Hunter, Thomas and Withers
T C Weston QC and S V A East for the First Respondent Magill
J B M Smith QC, A S Olney and C J Curran for Second and Third Respondents
D H McLellan QC and J S Cooper QC for Fourth and Fifth Respondents

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CIVIL APPEAL

MR CARRUTHERS QC:
May it please Your Honours, I appear with Ms Mills and Mr Abdale-Weir for the appellant.

ELIAS CJ:
Thank you Mr Carruthers.

MR GALBRAITH QC:
May it please Your Honours, I appear with Mr Cooper for the first respondents other than Sam Magill.

ELIAS CJ:
Thank you Mr Galbraith.

MR WESTON QC:
May it please Your Honours, I appear with Ms East for Mr Magill.

MR SMITH QC:
May it please Your Honours, Smith with Mr Olney and Mr Curran for the second and third respondents, the Credit Suisse parties.

ELIAS CJ:

Thank you Mr Smith.

MR MCLELLAN QC:

May it please Your Honours, I appear with Ms Cooper for the fourth and fifth respondents.

ELIAS CJ:

Thank you Mr McLellan. Yes Mr Carruthers.

MR CARRUTHERS QC:

May it please Your Honours, the untrue statement relied on by the appellant for the purposes of the appeal is this, that at least by the time of allotment the statement of prospective total operating revenue for the financial year ended 2004 was an untrue statement. That analysis accords with the finding in the Court of Appeal that I will come to, leaving aside the issue of materiality for a moment with which I will deal with also.

But the argument on an untrue statement goes further, the appellant's argument is during the whole of the period the prospectus was on offer, the statement as to operating revenue sales was untrue and that relevant period, while it was on offer is from registration on 5 May 2004 until allotment on 2 June 2004. It is that operative period during which the offer was available for acceptance by subscribers that is relevant to the appellant's argument.

Now the Court of Appeal's analysis of the facts leading to the conclusion on which I rely is at paragraphs 105 to 115 of the reasons for judgment. Now Your Honours, the reference I can give you is to the case and it is case volume 3. Now there is the consolidated bundle that actually has the case references and the document numbers but the references I am giving you are to the actual case on appeal. So the judgment of the Court of Appeal appears in case 3 and it starts at 1212. The passage that I'm referring to is at 1247 to 1250. Is that the easiest way for me to –

ELIAS CJ:

I think paragraph numbers is probably easier in the judgment.

MR CARRUTHERS QC:

Right. So this is really the analysis of the facts with which the appellant will take issue as I shall elaborate in argument but I'll go through the passage from 105 to 115 just so that there is a background of the facts that are in issue and what the Court found was that, dealing with the shortfall that, "This was a two month sale shortfall, there was ample evidence that sales figures can fluctuate significantly from month to month and there were explanations for that shortfall which suggested the downturn was temporary. If the market had been provided with the information regarding the shortfall, it would also have been provided with the explanation for it, as understood at the time. These included that March had been a strong month but retailers were taking some time to sell that product through. Scheduled plant closures had resulted in Feltex not being able to deliver certain sales orders by the required delivery dates and unexpected production difficulties, now resolved, had resulted in a $3 million shortfall on sales."

Now that proposition is then expanded in the successive paragraphs which I don't need to read but it comes to the conclusion at paragraph 116, "To conclude, by the time of allotment the statement of prospective total operating revenue for the financial ended 2004 was an untrue statement for the purposes of section 55 but the Judge had a proper evidential basis for his finding that the notional investor would not regard that shortfall as material in determining whether or not to invest in Feltex. And that conclusion harks back to a conclusion at paragraph 101 of the reasons that I'll just draw attention to so the analysis is complete and there the Court said, "In our view the evidence establishes that while the directors may have continued to believe that the forecast was correct as at 5 May 2004, by the time of allotment they knew there would be a shortfall in total operating revenue against that forecast" and then the analysis continues.

So as I explained when I opened the appeal, the untrue statement we rely on is that at least by the time of allotment the statement of prospective total operating revenue was untrue. In dealing with paragraph 116, the argument for the appellant is that the Court's analysis of the word "material" is wrong in the context of the Securities Act 1978 and I want to come to the statutory provisions to explain what "material" means in the context of the prospectus and the starting point on our argument is section 33 of the Act and in the electronic case that's under the authorities at tab 1. So that section 33(1) provides that, "No security shall be offered to the public for subscription by or on behalf of an issuer unless (a) the offer is made in or accompanied by an authorised advertisement that is an investment statement that complies with this Act and regulations or (b) the offer is made in an authorised advertisement that is not an investment statement or (c) the offer is made in or accompanied by a registered prospectus that complies with the Act and the regulations."

Now in this case we have an investment statement and prospectus all in the same document but the point is that no security shall be offered unless it complies with the Act and the regulations and looking ahead in the argument that is an absolute prohibition for the purposes of the way in which I developed the argument.

Now the question then becomes what is required to comply with the Act and the regulations and I will go forward to section 39 of the Act which deals with the form and content of the prospectus and the relevant provision for the argument is section 39(1)(c), that is that every, and we'll used "registered prospectus" because this is what this was, "Every registered prospectus shall contain all information, statements, certificates and other matters that it is required to contain by regulations made under this Act." Now in this in this part of the Act dealing with prospectuses, section 39 is the only provision that bears in any way on what is to be contained in a prospectus. Sections 40 to 44 deal with statements by experts and then registration, amendment and cancellation but there's no relevant provision that harks back to section 33.

So the next issue that arises is what the regulations require and I want to take you to those in our electronic bundle there, under authorities number 4 and these are the primary provisions dealing with the content of the prospectus and the argument for the appellant is that it is these provisions that determine what is material and really underpin what becomes an untrue statement. So if I can go to regulation 3. So I'm at regulation 3 dealing with the content of prospectuses and regulation 3(1), "Subject to regulation 4 of these regulations every registered prospectus that relates to an offer of equity securities shall contain all of the information, statements, certificates and other matters specified in schedule 1 to theses regulations that are applicable." And I don't need to deal with any other part of regulation 3, it's subject to regulation 4 which doesn't apply in this case that deals only with short form prospectuses. So regulation 3(1) takes us to schedule 1 and in schedule 1 the relevant provision on which we rely is first regulation 9, is clause 9 of schedule 1, I beg your pardon.

Now clause 9 provides that, these are what are required as contents of the prospectus. So the prospects and forecast, the clause is dealing with and, "The prospectus must contain a statement as to the trading prospects of the issuing group together with any material information that may be relevant thereto." And then in sub clause (2), "The statement required by sub clause (1) of this clause shall include a description of all special trade factors and risks" and then "not mentioned elsewhere in the prospectus, not likely to be known or anticipated by the general public and (c) could materially affect the prospects of the issuing group."

Now the other two regulations which I need to just draw attention to really are regulation 40. I beg your pardon clause 40 of schedule 1 which deals with other material matters under a heading of "Miscellaneous requirements. Particulars of any material matters relating to the offer of securities other than matters elsewhere set out in the registered prospectus or in the financial statements referred to in the registered prospectus and contracts entered into in the ordinary course of business." So it's simply particulars or any material matters not otherwise dealt with and then in clause 41, "The prospectus is

required to have a statement by the directors of the issuer as to whether, after due enquiry by them in relation to the period between the date of the latest statement of financial positions contained or referred to in the registered prospectus and the specified date, there have in their opinion arisen any circumstances that materially adversely affect the trading or profitability of the issuing group, value of the assets, the ability of the issuing group to pay its liabilities due within the next 12 months." And I just draw attention to the fact that "due enquiry" is a term that's defined in the Act itself under section 2B. I don't need to go there.

So what the submission is, is that any concept of what is material needs to be considered against this statutory background. Now I come from that statutory background to deal with the argument and particularly the factual matters which we argue should have been the subject of disclosure prior to allotment. Now the argument is recorded in the Court of Appeal judgment at paragraphs 57 and 58. I come to deal with the issue that's identified in these paragraphs in a little more detail in a moment but it's just important on the issue of interpretation to look at the proper approach, what we argue is the proper approach to interpretation of consumer protection legislation. So the argument was that, "The appellant argues that the Judge erred when he imported into section 56 a requirement that the untruth has to be material to trigger civil liability. He says this is an unjustified, reading down to section 56(1), inconsistent with the Supreme Court's guidance that as the Securities Act is investor protection legislation, these extremely broad primary provisions are to be given their ordinary meaning. The appellant says section 56(1) should be read to create civil liability for the respondents if he proves that the prospectus contains an untrue statement, particularly where there are statutory defences. He does not have to prove the misleading content was material to the decision to invest or that the particular statement caused him loss. It is sufficient if it is untrue. This is especially so as section 33(1) of the Securities Act prohibits in absolute terms the marketing of a security in a registered prospectus other than one which complies in all respects with the Securities Act. If the prospectus contains an untrue

statement it does not comply with the Securities Act and therefore should not have been distributed.

So that's the argument and it relies on, as the Court of Appeal identifies, on this being investment protection legislation and in that respect the appellant relies on the passages in fact identified by the Court of Appeal from *Re AIC Merchant Finance Ltd* [1990] 2 NZLR 385 (CA) and *Hickman v Turner and Waverly Ltd* [2012] NZSC 72, [2013] 1 NZLR 741 we also rely on *R v Moses* HC Auckland CRI-2009-004-1388, 8 July 2011 and I'll just draw attention to those passages on which reliance is put. The first one appears in paragraph 42 of the Court of Appeal judgment where the Court notes that the appellant cited the Court of Appeal in *AIC Merchant Finance* and that was Justice Richardson's judgment where he says, "It is perhaps true to say that the premise underlying the Securities Act, as with much commercial law, is that the best protection of the public lies in full disclosure of the company's affairs and of the security it is offering. That then allows the investor to make an informed investment decision which in turn facilitates the functioning of financial markets. It is I think for reasons of that kind that the Act places such emphasis on clear and accurate disclosure and that the key provision, section 33(1) prohibits the making of an offer of securities to the public unless it is made in or is accompanied by a registered prospectus that complies with the Act and all regulations made under the Act. The obligations are placed on issuers and neither directly nor indirectly are existing or potential subscribers required to check whether an issuer has met its statutory responsibilities."

And then this Court in *Hickman* in a passage that was cited and is recorded in paragraph 44 of the Court of Appeal's reasons, "In this way the purpose of the Act is the protection of the investing public against the risk that the issuer of a security may not be able to fulfil the contractual obligations it assumes under the security. The interpretation and application of the Act is to be approached from investor's viewpoint. The principal means by which the Act achieves its object is to insist that adequate and accurate information be provided to subscribers through a prospectus or by other means such that investors may

make informed decisions and better appreciate the risks that they may be taking."

Now in the submissions we rely also on the *R v Moses* and the passage at paragraph 51 of the submissions. I'll take you to the full passage. It's in the appellant's authorities at tab 23 or electronically at 23 as well and this was a prosecution under the Securities Act and the passage that I'm drawing attention to is from the reasons for the Judge's verdict. The trial Judge was Justice Heath and the passage appears at paragraph 36 of the case in these terms, "The purpose of the Act is the protection of investors" and he relies on *AIC Merchant Finance*, "Justice Richardson described the pattern of the Securities Act and the sanctions it imposes as designed to facilitate the raising of capital by securing the timely disclosure of relevant information to prospective subscribers for securities. The underlying principle is simple, full disclosure enables a potential investor to make an informed decision whether to invest. Equally a potential investor cannot make an informed choice without all information that is both relevant and material to the decision." And then picks up a passage that I've cited already.

So the point that comes out of the case is that whatever the actual test and there's some debate in the trial Judge's judgment in this case as to whether it's full disclosure or adequate disclosure, whatever test is adopted, it's plain that there needs to be substantial disclosure and the disclosure must comply with the regulations and that will be the theme of the argument that the disclosure is tied back to what the regulations require.

So I turn now deal with that factual basis and I'm going to run through the factual material on which I rely and then I want to tie that into what the regulations require and really put the question as to whether the disclosure that was made complies with the regulations. Where that's leading is that if there's non-compliance by disclosing material that the regulations recognise as material, that leads then to the prohibition in section 33 and that on our argument leads through to the remedy under section 56 and I'll discuss the requirements of that section as I come to it.

GLAZEBROOK J:

Is that non-disclosure, sorry you said non-compliance by non-disclosure of something material or something – well you say material means required by the regulations.

MR CARRUTHERS QC:

Yes.

GLAZEBROOK J:

Right or you say material means something that's not peripheral. Is that an alternative argument? I'm just trying to –

MR CARRUTHERS QC:

Yes I think that's a fair alternative way of putting it Your Honour but certainly my focus is on what the regulations require and what the regulations regard as material information to have available to the investing public. So I'm coming to that factual basis.

ELIAS CJ:

Material is a slightly loose word and one can see that perhaps in some of the judgments. Might it be, always dangerous to introduce other concepts, but might it be that relevance is established by the statutory framework, including the regulations but that there is still a non-trivial materiality that's required which is really I think what Justice Glazebrook was putting to you because there will be some errors which are neither here nor there.

MR CARRUTHERS QC:

Yes.

ELIAS CJ:

But once you're over that threshold you have a sufficiently material error.

MR CARRUTHERS QC:

Yes I accept that but the concept that I absolutely resist from some of the expert evidence is that materiality is an accounting concept and you look at it over a 12 month period. My submission, my strong submission is that is not the context of the securities legislation at all and particularly because the focus must necessarily by on the period that the prospectus was on offer which was on registration to allotment.

KÓS J:

The focus must necessarily also be on the words of 56(1) which require that the investment be on the faith of the statement or by reason of the untrue statement.

MR CARRUTHERS QC:

The loss sustained by reason of the untrue statement, the subscription on the faith of the prospectus. Can I just divert Your Honour for a moment because I'm coming squarely to both of those concepts because the way in which "by reason of" is really "as a result of", because of the prohibition in section 33(1), you look at what the consequences for the investor and really it's as a result of the untrue statement the prospectus has been left on offer and the investors had subscribed and lost. So that's really where the "but for" argument comes from and that's the way in which the appellant's case is put. I will come to that and elaborate on it.

O'REGAN J:

If the prospectus doesn't comply with section 33, isn't just the whole offer void?

MR CARRUTHERS QC:

Yes, well –

O'REGAN J:

That's what section 37 says.

MR CARRUTHERS QC:

Yes or avoidable is it?

O'REGAN J:

No it says it's void. An allotment made in contravention.

GLAZEBROOK J:

Well that's a good "but for" argument.

O'REGAN J:

Is invalid and of no effect.

MR CARRUTHERS QC:

If you interpret a registered prospectus that complies with the Act and regulations then Your Honour's argument is correct with respect. Although what I'm about to say is against me, you may be required to read section 37(1) as there being a registered prospectus, albeit one that contravenes section 33.

O'REGAN J:

I see.

MR CARRUTHERS QC:

So 37(1) really picks up concepts, really picks up cases like *Hickman* where there was no prospectus at all and there was a requirement for one. But Your Honour it is, in my submission, and with respect to you a perfectly respectable argument to interpret a registered prospectus in 37(1) as one being one that complies with the Act in which case 37(4) would come into play.

ELIAS CJ:

But why would you have section 56 if that were the case or 37A?

MR CARRUTHERS QC:

I'm really just trying to deal with Justice –

ELIAS CJ:

I know but surely that pushes you to the view that this is to catch the *Hickman* type case?

MR CARRUTHERS QC:

Yes. I want to begin the argument on the factual basis for the untrue statement by drawing attention to the Court of Appeal's judgment at paragraphs 84 through to 92 and again the Court of Appeal begins by setting out the appellant's argument there. It was argued for Mr Houghton before Justice Dobson that the revenue forecast for financial year 2004 was unreasonable given Feltex's trading history and was therefore an untrue statement for the purposes of section 55 and 56 of the Securities Act and misleading for the purposes of the section 9 of the Fair Trading Act 1986. The appellant says that by 5 May 2004, the date of registration of the prospectus, daily sales reports for April received by the chief financial officer, Mr Tolan, who sat on the due diligence committee and Mr Magill the chief executive officer, showed a significant shortfall for sales against the forecast which had been utilised in preparing the financial year 2004 forecast in the prospectus. Following registration of the prospectus there was a second month underperformance. Sales for May were also significantly behind forecast. By the time of the allotment of securities in June 2004, the board of directors knew there had been two months of shortfall in sales. They therefore knew that the forecast figures for financial year 2004 were incorrect and on Mr Houghton's case untrue statements in terms of section 55, yet the company proceeded to allot securities.

ELIAS CJ:

Is that an accurate assessment of your submission that it was untrue in terms of section 55?

MR CARRUTHERS QC:

No it's not, no.

ELIAS CJ:

No, that's fine, you can go on, I understand the point.

MR CARRUTHERS QC:

And I don't need to go into the section 55 issue but if I can make it clear that I disagree with the Court of Appeal's analysis. You can have an untrue statement or you can have a section 55 statement which is a deeming provision which makes it –

ELIAS CJ:

Which expands it?

MR CARRUTHERS QC:

Yes it does but I don't need to go there because I've got a finding in the Court of Appeal of untrue statement in fact. There's then an analysis of the factual background that the Court of Appeal has found and I'm going to go over that background with reference to the documents. So I'd simply draw attention to that analysis by the Court of Appeal. I'm dealing with that part of the appellant's submissions that appear in paragraphs 18 through to 23 on pages 11 and 12 of the submissions. I don't need to take you there but just so that you know what the oral argument is directed to, it's that passage in the submissions that deals with untrue statements.

Now I want to turn to the features of the facts that are relevant to the Court of Appeal's analysis and I'll start by just drawing attention to the provisions in the prospectus that bear on the sales issue and the prospectus is in volume 22, beginning at 9172 and the marketing strategy is at 9224. These are just short passages that deal with the marketing strategy. The prospectus page number is 51. There are really only two short passages I need to go to on page 51, right at the top of the page on the left-hand column "Feltex strategies. Feltex has a defined set of strategies to grow sales and to continue to enhance margins and reduce costs in order to generate improved cash flows to shareholders" and I think the only other short passage that bears on the argument is at page 16 of the prospectus and I'll give you the electronic

references, it's volume 22 again at 9189 and I'm in the right-hand column of the prospectus about half way down. "A positive outlook for carpet demand with sound residential and commercial building activity is expected to support Feltex's sales through the financial year 2005."

So that's simply on the marketing strategies that Feltex said were in play and I need to just identify the forecasts for you. Page 85 of the prospectus and the electronic reference is 22 9258 and I'll be referring through to 9260 and 9262 but just on these three pages and this is the forecast through to June 2004 on an annual basis and in terms of the notes on the forecast at page 89 of the prospectus under the heading "revenue" near the top of the page, the prospectus notes, "The forecast assumes that demand for Feltex products continues the trend experienced over the nine months ended March 2004 adjusted for increased fourth quarter seasonality that a small volume of new product is introduced into the market and that existing customers will continue to trade with Feltex at their current levels." And those observations in the prospectus are relevant to what in fact we come to by way of evidence as at April and May 2004.

Now the actual performance, the budgeted performance and the forecast figures are set out in a monthly report which are part of the group operating reports and I come to deal with those in terms of the factual information that is relevant and the material I'm taking you to, I'm asking you to consider this in the context of the statutory requirements particularly identified from the regulations. Now I'm going to an extract from the group operating report for April 2004. Electronically it's at 16/6380.

GLAZEBROOK J:
It looks like it's tab 240 in volume 3 of the consolidated bundle.

MR CARRUTHERS QC:
And go through to 6389 which is the commentary on the group financial results and that's part of the group operating report for April 2004. And against the background of those passages in the prospectus that I took you

to, I want to take you through this commentary on 6389 in this way. You'll see that the table at the top sets out actual and budget figures in volume terms and in Australian dollar terms and the narrative –

GLAZEBROOK J:
How does the budget link up with the forecasts?

MR CARRUTHERS QC:
I think that they are similar is the way in which Tolan put it when he was cross-examined on it but Your Honour I am going to come to part of that monthly report that actually gives you the actual and the budget and the forecast.

GLAZEBROOK J:
Thank you.

MR CARRUTHERS QC:
So what the report starts with is that the total carpet volume was under budget by 19.5 per cent and the reason given for that, reflecting a quieter than expected month by retailers and a fall in orders following a peak in March and the reason given, “This was partly influence by efforts of retailers to achieve rebate incentives for the March quarter” and then there's a residential and mass.

KÓS J:
Mr Carruthers, so what's the precise date of this document?

MR CARRUTHERS QC:
It is the report for April 2004.

KÓS J:
Well do we know when it was produced?

MR CARRUTHERS QC:

Well I know it was part of the papers that begin at 6380. So just go back to that.

O'REGAN J:

The board meeting was on the 27th of April it says.

MR CARRUTHERS QC:

No but this will be the May meeting.

O'REGAN J:

Oh so these are the minutes of the previous meeting?

MR CARRUTHERS QC:

Yes but this Board report, let me answer your question this way, these figures were available to at least Mr Tolan and Mr Magill by the end of April 2004. So as at the end of April 2004 you've got carpet volume under budget by just under 20 per cent, down two bullet points, total carpet revenue was 22.8 per cent below budget and it's noted that that was largely a result of lower volumes. Average selling price were also contributed to lower sales and this partly due to higher than budgeted sales of discounted seconds and aged stock. Then dropping down, I invite you to read the whole of this report. I'm just picking the highlights for my argument.

The next bullet point but one beginning, "Carpet margin dollars was 6.1 per cent below budget on significantly lower sales, reflecting a lower cost mix and favourable operating variances in Australian manufactured carpet due to the release of the SIP innovation grant receipts and adjustment for accrued work cover.

Then I go through to page 6392 and looking at the sales overview for that month, "After analysing the month's performance there is no doubt that we got the calendarisation of the month wrong compared to last year with Easter, Anzac Day and school holidays. All retail markets across Australia reported a

slow trading month." And then dealing with two styles Redbook and Minster and I deal with them separately for Australia and New Zealand as the report does. As with the case in the wool division the synthetic brands perform no better and the reasons were the same, short month, very poor store traffic and then Red Book and Minster for Australia finished on 76 per cent of volume, 73 per cent of volume and 89.9 per cent of margin and then dropping down to Red Book and Minster for New Zealand, Red Book achieved 77 per cent of value, 75 per cent of volume and 83.9 per cent of margin and dropping down bullet points, Minister achieved 74 per cent of value, 84 per cent of volume and 69 per cent of margin. Next bullet point, "On the surface this brand appears to be performing poorly but synthetic results should be combined which would give us a better picture as performance plus was transferred from Minster to Red Book and we have been slow in replacing that value volume in polypropylene."

Now from that commentary, I'll take you to the comparative figures table which is at 6406. This is again is part of the group operating report for April and you will see on the second line down there is recorded for April the actual sales figure of 24271. The budget of 30585 and the forecast for that month of 29828. Now what the commentary gave us was the shortfall between actual and budget, it was the figure of 22.8 per cent. The shortfall between forecast and actual is the percentage figure, the 24271 bears to 29828 and that is a figure of just over 19 per cent. So there was a shortfall of actual against forecast of 19 per cent for April.

Now coming through now to May and again these were the figures available at the end of May prior to allotment in June and the reference there is electronically 17/6885 and I'm going to 6894. Can you give me a bundle reference for that? 243 in volume 3.

GLAZEBROOK J:
6894.

MR CARRUTHERS QC:

So picking up the commentary on the position in May at 6894 you'll see, “Total carpet volume was under budget by 17.8 per cent reflecting a quieter than expected month in both the residential and commercial sectors.” And then there is a commentary on the differences. Go down two paragraphs, “Total carpet revenue was 23.2 per cent below budget. This was largely as a result of lower volumes. Average selling prices were below budget in the residential segment which also contributed to lower sales. This was partially due to higher than budgeted sales of discounted seconds against aged stock. Overall residential was 21.9 per cent below budget, mainly due to lower volumes and lower average selling prices. Premium was at 43.2 per cent below budget and the shortfall is largely volume related.” I will read the whole paragraph. “The middle segment was .4 per cent above budget despite volume exceeding budget by 14.2 per cent. This was also due to lower than expected average selling prices partially resulting from increased sales of seconds and aged stock. The mass segment was 27.5 per cent below budget also due to lower volumes and sales of second and aged stock. Total commercial was below budget by 19 per cent mainly due to lower volumes in Australia and offset better than expected average selling prices.” Next proposition, “Carpet margin dollars were 11.2 per cent below budget on significantly lower sales reflecting a lower cost mix offset by favourable operating variances, materials and stock obsolescence in Australia and New Zealand.”

And then going forward to 6898 the proposition is, “We need to work on Carpet Call as they are not giving us any support.” And then coming down to the heading, “Feltex Classic Australia. Poor performance across all indicators in Australia. Carpet Call who had their worst month ever was a major contributing factor. Jim Smith is not giving us any support whatsoever.” Next, “Our successful sell in of the four classic ranges have not yet been sampled. We have sold 118 dealers the four new ranges. We have put in place rebates and promotional prices should improve in the future.”

Dealing with Feltex Classic New Zealand, second proposition, “Poor stock levels adversely impacted the May result especially considering that it is affecting new product ranges, for example, Mercury was out of stock by up to five colours this month. We have over 3000 metres on back order in this premium brand. Some production is not coming through till late August.” And then, “Promotional Goods. Following a very good month in April, May continued with a further $2 million in shorts, seconds and redundant totalling five million for the two months. The proposition there involves clearing out stock in order to increase sales figures.”

And then the opposition activity, “Godfrey Hirst and NEC New Zealand have told retailers that they intend to keep their mills running at capacity. This has already been shown with a heavy-duty hard twist selling as low as $69, our best price $75. NEC selling a Fanuli lookalike at $79 versus Feltex $89 and Condor heavy duty twist lookalike at $45 versus Feltex $50.

O’REGAN J:
Whose writing is this here? Is it one of the directors or is it done later or don't you know?

ELIAS CJ:
It looks like one of the directors but there may not have been evidence of that I suppose. Well it is obtained on discovery presumably, it doesn't matter, Mr Carruthers if you don't know.

MR CARRUTHERS QC:
It is part of the directors’ papers and let me take you now to 6911 which is the equivalent monthly table for May to that I took you to in April. You will see that the sales figure actual for May is 26657. The budget is 33982 and the forecast is 32959, and again that figure is just over 19 per cent, a shortfall of actual against forecast for May.

Now the other table that I want to take you to is the table at the back of the appellant’s submissions, it's the last table.

O'REGAN J:

Have we finished with this volume now?

MR CARRUTHERS QC:

Yes, thank you. This is the table I'm taking you to, it's the very last table on the page and the figures at the top are the figures from Professor Robb's evidence and what has been done is to convert those into a graph form and the blue is actual to the end of May 2004. The red is forecast for April and May but is budget from July 2003 through to March 2004. Perhaps the way in which it is recorded on the right-hand side is just a little bit misleading but April and May are forecast in red and for the prior periods they are the budget figures and you actually get that from looking at Professor Robb's figures across the top and the green is simply to show frankly the lack of performance of Feltex over that year.

Now I had better just add this, that at 10 to nine last night I received an email from my learned friend Mr Smith challenging that table if we proposed to use it. I simply haven't had an opportunity to look at what he is saying about it. I've discussed it with him this morning and we can just deal with any issue that arises in reply if there is an issue. I think his point, in fairness to him, the point he wanted to make is that I should not think that they did not challenge those figures. So I'm on notice about that.

ELIAS CJ:

That's Rob's figures?

MR CARRUTHERS QC:

Yes. Now from that analysis of those factual matters in April and May, I submit that the issues is whether in terms of regulation 9 these factors affect the trading prospects which is the issue under clause 9, I beg your pardon clause 9 of schedule 1. The issue is whether those factors of being behind budget on volume and sales and seriously behind budget by in round figures 20 per cent budget against actual and the same actual against forecast so that when one comes to look at the prospectus, the forecast was 20 per cent,

round figures, out. Now my submission is that that figure affects trading prospects.

The other issue under clause 9 is whether it is material information relative to the trading prospects of the group and my submission is that it is or again in terms of clause 9 whether they include special trade factors or risks that fall within clause 9 and another alternative is to look at whether they are a material matter to the offer in terms of clause 40. So the argument is that these factors should have been disclosed because they are material in the sense that that word is used in the regulations. The disclosure which should have been before allotment was that the company is more than 20 per cent behind budget and forecast for each of April and May.

And just bear in mind that by June, no let me go back a step, by May, by the time of registration of the prospectus on the 5th of May, the results from April were certainly known to Messrs Tolan and Magill but they were also material that the directors had access to prior to the registration of the prospectus. So even at the end of April you're looking at round figures 20 per cent behind budget and forecast and when one comes forward to allotment in June, there is not only April there is then May with the same sort of pattern. So my submission is they're matters which plainly affect the trading prospects, they're material information relevant to the trading prospects and from the sort of narrative that appears in the commentaries, they include special trade factors or risks in the regulations.

GLAZEBROOK J:
The trade factors or risk you rely on is that the sell offer? Basically the volumes that were, were volumes from sell off and also the issues with the competitors that are in the second one. Are those the only ones?

MR CARRUTHERS QC:
Yes exactly, well also the calendarisation issue in April. I mean it really, one wonders about how you could overlook Easter and the school holidays in a budget context. So let me just go to the –

GLAZEBROOK J:

Well that's saying that that's not something new that should've come up, that should've been taken into account in any event in the forecast. That's the submission on that issue.

MR CARRUTHERS QC:

Yes.

O'REGAN J:

But it does seem to be referring to an external factor rather than something wrong with Feltex itself, I mean apart from bad budgeting practice. It's not suggesting that Feltex's products are deficient or anything like that is it?

MR CARRUTHERS QC:

No, no. I just want to answer the Court of Appeal at paragraph 105. It's in that passage I took you to earlier where the Court of Appeal said that this was a two month sale shortfall. "There was ample evidence that sales figure could fluctuate significantly from month to month and there were explanations for that shortfall which suggested the down turn was temporary. If the market had been provided with the information regarding the shortfall, it would also have been provided with the explanations for it as understood at the time" and then these included and I've read that passage to you but whatever explanation was given by the company for the shortfalls and the prospects, an investor would be entitled to ask why should we believe what you are now telling us about prospects when your forecast of virtually contemporaneous sales figures is not accurate by more 20 per cent particularly in view of the sales history of the company and I'm looking back at the graph that I showed you. What prospect of investment would there have been if disclosure had been made of those matters that I've canvassed on the facts. So my submission is that the point is that the regulations required this information as it was material in terms of the regulations and it was not given. It is no answer, in my submission, to say that oh we thought that we would be able to meet forecast when in any event it wasn't met but again my focus is what was the position at the time of allotment because it is that period when the

prospectus was on offer from the 5th of May 2004 to allotment on the 2nd of June 2004 that requires to be considered.

O'REGAN J:
How significant is the shortfall in these months when you annualise it because we're talking about a forecast for a 12 month period aren't we?

MR CARRUTHERS QC:
No we're talking about a forecast for three months, we've got April, May and June and we're talking about projection for the 12 month period.

O'REGAN J:
But what's in the prospectus is a forecast from what will happen over the whole year including the nine months that has already gone isn't it.

MR CARRUTHERS QC:
Yes.

O'REGAN J:
So the fact you fall 19 per cent short on one month, how does that affect the overall, I mean because in the end they did get to about 98 per cent.

MR CARRUTHERS QC:
That's right, I think if you look at it on an annualised basis it was something under three percent short but with respect, Your Honour, that in my submission is not the enquiry, the enquiry is as to what was required to be disclosed by the regulations and whether that was material in the sense of being information that an investor was entitled to have and that's why I really asked the rhetorical question well if an investor was told that look we've been able to – we've made these shortfalls of 20 per cent which in my submission is a very significant shortfall in percentage terms in April and May against both budget and forecast but we think we're going to make it up. Now surely an investor is entitled to that that information and make his or her own decision

as to what is done, as to whether what is then said to the investor is information that could be believed.

O'REGAN J:

Well the prospectus is required to give the forecast for the 12 month period, so the question is, is this something which is so material that it makes that forecast materially wrong, isn't it?

MR CARRUTHERS QC:

Well no. Yes the prospectus is required to do a forecast in that way but the relevant question in my submission is that the prospectus is bound to disclose information about the trading prospects and that information about the trading prospects was that we have fallen short by 20 per cent

O'REGAN J:

I thought your pleaded claim was that the forecast for the 12 month period was materially wrong, not that there was a bad month which itself was a separate issue that had to be disclosed on its own.

MR CARRUTHERS QC:

Well I think the way in which I have picked up the argument is to take what the Court of Appeal has found was the untrue statement and then look at the issue of whether it was material and in that sense that's my direct challenge to the Court of Appeal's finding.

O'REGAN J:

But they don't seem to be talking about the regulations there, do they, is that a new argument or is that something was run there as well?

MR CARRUTHERS QC:

Well I suppose in the nature of appellate argument when it is certainly a refinement but I think you will find the regulations have been in issue but they perhaps have not had the focus that I have put on, because what I am challenging is really what material means and that the way in which the

Court of Appeal has interpreted material is wrong in the sense that its inconsistent with the requirements of the regulations.

KÓS J:

You wouldn't just look at those two months. You would look at the whole of your graph at the end of the table, at the end of your submissions, wouldn't you? And that doesn't show a particular trend, it shows months up and months down. March is a problem here, is it not? If there was a trend there might indeed be something calling for special advice.

MR CARRUTHERS QC:

Well you have seven months which are distinctly down –

GLAZEBROOK J:

That's from budget, isn't it?

MR CARRUTHERS QC:

Actual to budget, well in fact I've incorporated both budget and forecast. You have five months significantly down and you have four months which are barely ahead. So if it's not a trend it's a significantly poor performance against budget.

O'REGAN J:

But presumably the poorness of the performance up to March is already factored into the forecast, isn't it, because they're going on actual figures for the months that have already elapsed in the year so what was budgeted in those months is sort of irrelevant now, isn't it?

MR CARRUTHERS QC:

Looking at it through the lens of the investor and looking at that question of trading prospects and the investor is told that this is the position in April and May, the investor – one issue for the investor would be to look back at what had happened up to that point which is the relevance of the graph.

KÓS J:

Are you saying that the whole of the graph, that data should have been produced so that an investor could say, “Gosh Feltex aren't very good at forecasting, good carpets, bad forecasters.”

MR CARRUTHERS QC:

Well I probably need to be a little careful there because I suppose from the information in the prospectus and by inquiry an investor could reconstruct the graph prior to April. I mean my focus is purely on the offer that was made and the significance of the information that was available to the company that should have been disclosed as part of the offer so that the investor has the material that it amounts to full information, adequate disclosure with whatever test but it is from the investor’s point of view that this needs to be considered.

O’REGAN J:

But is the material that should have been disclosed the whole of this graph or just the bad news of April and May?

MR CARRUTHERS QC:

I have focused on April and May because that's the issue period, that's the section 33 period.

GLAZEBROOK J:

Although the argument that these were just one-offs in terms of not getting the forecast right is perhaps given the lie to if you look back at the budget against forecast so you could argue that it probably wasn't pleaded that in fact in the light of the fact that they weren't very good at forecasting obviously you couldn't say these were just one-offs. So that if in fact this was an aberration, April and May, and you just happened not to be very good for April and May but if it's been a part of a pattern of not being very good then that might be more significant but I'm not sure that was the way the case was put, was it? Well I think it was sort of put in the High Court that this was all wrong but –

MR CARRUTHERS QC:

I mean even at this stage – of the Court of Appeal argument – where you'll appreciate from the Court of Appeal argument that there were a number of arguments about untrue statement.

GLAZEBROOK J:

Yes.

MR CARRUTHERS QC:

And this is lying, the focus of the case is necessarily changed because of the way in which the Court of Appeal has decided.

ELIAS CJ:

But your principal point is that if it was aberrant that is something an investor is entitled to judge and you need the information.

MR CARRUTHERS QC:

Yes, with respect Your Honour, yes.

O'REGAN J:

So the argument is not so much that what was in the prospectus, the forecast itself was misleading, the argument is that there was a failure to disclose information that the regulations required to be disclosed in addition to the forecast or to explain the forecast.

MR CARRUTHERS QC:

Well it makes the forecast of the operating revenue wrong and it makes it that is where the untrue statement comes from.

O'REGAN J:

So is your argument that information about April and May had to be disclosed or is your argument that there should have been a new forecast that factored in the information about April and May?

MR CARRUTHERS QC:

Well I think the argument would be that the company has probably two options, it can amend the prospectus or it can withdraw the prospectus prior to allotment but what it can't do is continue to have the prospectus on offer and to go to allotment without disclosing the information that I've identified.

KÓS J:

But your premise that its wrong surely isn't right because we have the benefit of hindsight and we know what was in those two months a 19 per cent adverse figure ended up year whole 3 per cent adverse. So the forecast wasn't wrong because of those two months.

MR CARRUTHERS QC:

Well, Your Honour, the inquiry has to be, as I have submitted, through the lens of the investor in the period between May and prior to allotment in June, that's the relevant inquiry. I mean you're right about all of this being in hindsight. In fact if we go right through we can get a pattern within a 12 month period leads very much to an ominous conclusion that ultimately eventuated but that is very much a hindsight argument and I mean if one can look at what result was achieved on the IPO from the point of view of the value of the company beforehand, the amount of money that was taken out and the value of the company afterwards but none of those arguments are actually relevant to that window when the prospectus was on offer.

Your Honours, that actually takes me through the remedy question. So I'm going straight from there to section 56. It's a little early but –

ELIAS CJ:

Is that a convenient time to –

MR CARRUTHERS QC:

Is that convenient?

ELIAS CJ:

Yes we can take the adjournment now.

COURT ADJOURNS: 11.26 AM

COURT RESUMES: 11.43 AM

MR CARRUTHERS QC:

I turn now to the consequence of the untrue statement. So my argument is the absolute prohibition in section 33, the existence of the untrue statement means that the analysis leads to straight to remedy under section 56 and there are two aspects to section 56 that I need to argue. The first is that the liability to pay compensation is available to all those who subscribe for any securities on the faith of a registered prospectus which contains any untrue statement. So the issue is whether the appellant in this case subscribed on the faith of the prospectus and what in fact "on the faith of the prospectus" involves. It is significant that it is "on the faith of the prospectus which contains any untrue statement" and it's not a subscription on the faith of any particular statement true or untrue and that was the point of the distinction that – the distinction is in fact drawn in the cases relied on by the Court of Appeal in paragraphs 66 and 68. It's *Broome v Speak* [1903] 1 Ch 586 (Ch) and *Arnison v Smith* (1889) 41 Ch D 365 (CA). where the Court of Appeal is looking at this issue really starting at paragraph 64 and the difficulty is picked up at paragraph 67 in *Broome v Speak* where Justice Buckley put the problem this way, "It is unintelligible to say that a person relied upon a fact which he was not told or relied on his being not told a fact, and when you call a man after the event to say whether, if he had known a particular fact he would've done something or not, speaking for myself, it is so difficult to say exactly what a few years ago you would've done under different circumstances, that I should regard that evidence as of very little value. Be the man the most honest man possible, it is so easy to be wise after the event, that it is difficult for any man to say what he would've done under circumstances which did not arise. It is too much to expect of his that he should be able to say fairly what he would've done under those altered circumstances. The test I think to be

applied is it has been so stated by Lord Halsbury, and was so stated in *Smith v Chadwick* (1882) 20 Ch D 27 (CA), and will be found in many cases –that if you find that the matter withheld is such as that if disclosed it reasonably would deter or tend to deter an ordinarily prudent investor from applying for the shares, then is he entitled to relief."

And the Lord Chancellor, Lord Halsbury in *Arnison v Smith* at paragraph 68, "It is an old expedient and seldom successful to cross-examine a person who has read a prospectus and ask him as to each particular statement what influence it had on his mind, and how far it determined him to enter into the contract. This is quite fallacious, it assumes that a person who reads a prospectus and determines to take shares on the faith of it can appropriate among the different parts of it the effect produced by the whole. This can rarely be done even at the time, and for a shareholder thus to analyse his mental impression after an interval of several years, so as to say which representations in particular induced him to take shares, is a thing all but impossible. A person reading the prospectus looks at it as a whole, he thinks the undertaking is a fine commercial speculation, he sees good names attached to it, he observes other points which he thinks favourable and on the whole he forms his conclusion. You cannot weight the elements by ounces." And with respect that leads to the argument that on the faith of the prospectus means that the appellant in this case has obtained a copy of the prospectus, read it, taken advice from his broker on it that the broker is supporting and promoting the offering and recommends it. Now it must be on the basis of those passages from *Broome v Speak* and *Arnison* that on the faith of the prospectus means looking at the prospectus as a whole; that is looking at a prospectus which complies with the Act and the regulations.

ELIAS CJ:

Well it may in fact be even simpler than that, it may be who invest through the prospectus if you have to have it but "on the faith of" is such an odd expression really, it must be derived from this quote one would have thought.

MR CARRUTHERS QC:

Mmm and what the passages suggest is that one's looking at the prospectus as a whole as Lord Halsbury said, the nice glossy presentation of it.

O'REGAN J:

The Act actually doesn't require investors to be given the prospectus does it? I mean you can just give them an investment statement?

MR CARRUTHERS QC:

That's right.

O'REGAN J:

So how would section 56 apply then?

ELIAS CJ:

Well they're still investing through the prospectus, on the faith of the prospectus.

O'REGAN J:

Well they don't even see the prospectus.

ELIAS CJ:

No but there can't be an offering.

GLAZEBROOK J:

Well then it can't possibly mean that you have to have read it.

ELIAS CJ:

No I don't think you do necessarily.

GLAZEBROOK J:

I mean it might've been in the past that you had to have read it but I would've thought they're investing on the fact that there is a registered prospectus and they're assuming that it doesn't include any untrue statements.

MR CARRUTHERS QC:

With respect Your Honour –

GLAZEBROOK J:

And are entitled to assume that because if it did it shouldn't be there.

MR CARRUTHERS QC:

Yes that's right, and the practical reality is the sort of situation that arose in this case where people consult a broker and a broker says this, I recommend this and may or may not send out a prospectus. In this case a prospectus was sent out. So, with respect, I think that on the faith of is a test that is satisfied in the present case, and I will give you the reference to the evidence on this. It is in volume 4 and the evidence-in-chief of the appellant begins at 1307 and the relevant paragraphs are at 1309 and they are paragraphs 7 and 8. Now he is cross-examined at length much along the lines that are criticised in those cases. The cross-examination begins, again in volume 4, 1370 at pages 1371 to 2. They are pages 65 and 66 of the transcript and again there is a lengthy passage that runs through from 1378 to 1390 at pages 72 to 84 that the cross-examination continues beyond that but that's the reference if Your Honours are looking as to what actually was done. So that brings me to the second aspect of section 56 and that is –

GLAZEBROOK J:

Can I just say that it seems to me to be exceedingly odd where you don't need to read a prospectus to have that sort of detailed analysis as to what you relied on however untrue the statement was on the prospectus so that the only people then who could actually recover would be the people who did read the prospectus which in fact doesn't need to be sent to investors at all and all of the poor people who invested on the basis of someone else reading the prospectus or not and just giving them the information that it was a good deal would be immune – or the directors would be immune and promoters would be immune from a claim from them – and it seems odd in terms of the scheme of the Act that that would be the case.

MR CARRUTHERS QC:

Yes.

GLAZEBROOK J:

However untrue the statement is that if you didn't happen to ask for the prospectus which doesn't have to be sent for you then everybody is home and hosed in terms of liability, it would be, it seems to me, a very odd interpretation. That's not obviously a comment that your friends might wish to deal with.

MR CARRUTHERS QC:

Yes, and I can say that it doesn't arise in this case because of the evidence that I have got as to the use of the prospectus.

OREGAN J:

It might arise for other investors though.

MR CARRUTHERS QC:

Yes.

KÓS J:

In that case there'll be two readers, there's the investor and the investor's broker who they've talked to and one might imagine different degrees of comprehension and different degrees of attention.

MR CARRUTHERS QC:

Yes.

KÓS J:

It's probably a point for you.

MR CARRUTHERS QC:

Yes I understand that, yes, and I'm just reflecting on just the position of the broker where the investor would be able to say, "Well I was investing on the faith of the prospectus because I rang my broker and my broker told me about

it and it was on what he was telling me about it that led me to accept his recommendation and invest," yes.

Now the second aspect of section 56 which I must meet is that the liability to pay compensation is for the loss or damage they may have sustained by reason of such untrue statement. Now my argument in this case is that this situation is analogous with the section 37 situation, it's analogous with *Hickman*, it's different but the same reasoning applies.

O'REGAN J:
37A or 37?

MR CARRUTHERS QC:
No 37, the provision that Your Honour asked me about because *Hickman* went off on the basis of section 37 and the absence of a prospectus at all in that case meant that an allotment of securities was in breach of section 37 and that the appellant was entitled to relief. Now the passage – it's really the whole of the reasoning in *Hickman* that leads to that result. There's one passage that I'll just draw your attention to. It's case 22 in the authorities and I'm at paragraph 85 of the case. I should probably go back to 84 where the Court concludes, "For the reasons we have given, we are satisfied that Blue Chip's marketing of its investments products was in breach of the Securities Act, on the basis that these investment products were debt securities offered to the public without a prospectus." And then it was an issuer and the exemption is not applicable. "The developers argued that if we were to reach these conclusions, this would not impeach their ability to insist on performance, by the investors, of the sale and purchase agreements." And then at 85 the Court concludes, "We do not propose to respond to all of these arguments. This is because we considered that this aspect of the case, as with all others, must be determined on the basis of the language used and the policy underlying the Securities Act. As will become apparent, we have concluded that the sale and purchase agreements are rendered unenforceable by section 37." What happens there is where there is a

prohibition as in section 37, that leads to the conclusion that the loss arises by reason of the untrue statement.

Now to the same effect is the *Australian Softwood Forests Pty Ltd v Attorney-General (NSW); Ex Rel Corporate Affairs Commission* (1981) 148 CLR 121 case, that's under tab 16 and it's not an easy case. It concerned, well in fact I think just as a lighter moment I should just cite a passage from Justice Murphy's judgment who rather captures the sort of scheme that was involved in *Softwood*. It's under tab 16 and it's on page 136 where Justice Murphy said, "One of the most widespread and successful of the species of fraud known in Australia and elsewhere as 'the investment racket' is the forest or plantation variety. In the simple version the investor victim is induced to pay either outright or by deposit plus instalments for an area of land as part of a scheme in which trees will be planted and harvested on this and other investors' land. The investor expects that when the trees are fully grown he will receive a handsome reward from the product. The schemes are generally designed so that all the investors will ever receive are the pieces of paper constituting the agreements."

Now from that analysis of the facts, let me take you back to page 129 which is in the judgment of Justice Mason and he's dealing with the legislation dealing with prohibition and he says that in the bottom of 129, "The context is that of prohibitions against issuing or offering to the public for subscription or purchase or inviting the public to subscribe for or purchase 'interests' unless there is in force in relation to them an approved deed and unless there is provided information similar to that which is prescribed in connection with an offer to the public of shares," and what the Court found in *Softwood* was that there was a breach and that led directly to declarations of breach. It's obviously in a slightly different context but the submission is that the result is equivalent because of section 33. So what I tackle –

ELIAS CJ:

Just encapsulate your submission on this that?

MR CARRUTHERS QC:

Under section 33 there was a complete prohibition on making an offer unless you comply with the Act and regulations. There was non-compliance with the Act and regulations by reason of the untrue statement.

ELIAS CJ:

Ergo.

MR CARRUTHERS QC:

Ergo, yes.

O'REGAN J:

But in fact on the Court of Appeal's finding there wasn't a problem with the prospectus until the end of the offer period. So the problem was not amending it, wasn't it, rather than breaching section 30 by issuing it.

MR CARRUTHERS QC:

Sorry, Your Honour, could you just put that to me again?

O'REGAN J:

Well I thought the Court of Appeal's finding was that the prospectus wasn't misleading when it was issued so the offer made in the prospectus wouldn't have been in breach of section 33 but they found it became misleading by the end of the offer period and so the problem was that the issuer didn't amend the prospectus in terms of section 34 rather than that it made an illegal offer under section 33.

MR CARRUTHERS QC:

Well that's really why I took you back to paragraph 101 because what the Court said there, "In our view the evidence establishes while the directors may have continued to believe that the forecast was correct as at 5 May 2004 by the time of allotment they knew there would be a shortfall in total operating revenue against that forecast." So the reason I took you through the evidence was to illustrate or demonstrate that the directors had to know by 5 May that

there was, that there were the shortfalls and certainly had to know by the time of allotment. So I think –

O'REGAN J:

By 5 May they knew that April had been a bad month.

MR CARRUTHERS QC:

Sorry?

O'REGAN J:

By 5 May they knew that April had been a bad month and they knew that that was because Easter and the Anzac Day and so on all fell in April. But the real problem, at least on the Court of Appeal's calendar, seems to have been that when they had the combination of April and May at that point they should have said, "Well hang on, we're not going to be able to reach this forecast." And isn't that why the Court of Appeal amended its judgment by recall to say the problem wasn't at the beginning of the offer it was at the end of the offer period?

MR CARRUTHERS QC:

Well what I'm arguing in front of you is that whatever the Court of Appeal said about May if the analysis Your Honour is making my submission is that that analysis does not accord with the facts and that by the 5th of May the directors had to know that there was a problem not just a superficial problem because when one goes through all of those factors in the April report it's much more significant than that and when you look at the report and you've got the issue, not only actual against budget but you've also got an issue of actual against forecast. So my submission is that if that analysis that Your Honour takes from the Court of Appeal, then the Court of Appeal's analysis is wrong.

O'REGAN J:

I understood your argument was a cumulative argument but you're saying it's not. I thought you were saying April might've been explainable but once you

had April and May together then you had to know there was a problem but if that's so, that could only have been at the end of the offer period.

MR CARRUTHERS QC:

No I think the way I opened the appeal was to say that the untrue statement relied on by the appellant for the purposes of the appeal is that at least by the time of allotment the statement was untrue and in doing that I was picking up what the Court of Appeal had said in paragraph 116.

O'REGAN J:

Well that's what I'm saying.

MR CARRUTHERS QC:

Yes but then I went on immediately to say but during the whole period the prospectus was on offer the statement of sales was untrue and the relevant period is from registration in 5 May through to allotment, so my submission –

O'REGAN J:

So you're saying the April figures on their own are enough?

MR CARRUTHERS QC:

Yes, yes. Now coming to this –

ELIAS CJ:

So just to be sure, does that mean you're not making any argument based on section 34 was it, was that your question Justice O'Regan?

GLAZEBROOK J:

Well would you say even if that's right an amendment has the same effect because if the prospectus couldn't be out there unless it was amended then it shouldn't have been out there in the same way as under section 33 because there's a continuing obligation of disclosure, which I think was said somewhere? I can't remember where now.

MR CARRUTHERS QC:

Well I think certainly the underlying purpose of the offer is that there is a continuing obligation of disclosure.

GLAZEBROOK J:

So 34 would have exactly the same effect, they should have withdrawn it before allotment?

MR CARRUTHERS QC:

Yes and if you look at the exact wording of 34, it actually is on a different issue from 33 but as Your Honour says, I mean it's the prohibition in 33.

O'REGAN J:

Yes but the prohibition of 33 is on making the offer isn't it? So if what I have – if the Court of Appeal was right, the making of the offer wouldn't have become unlawful until the prospectus became misleading and that would only have been right at the end of the period.

MR CARRUTHERS QC:

Well if you analyse it that way, that it is an offer to the public from the time of registration through to the time of allotment. If you analyse it that way, yes it doesn't become untrue until the end but that is not the argument that I make.

GLAZEBROOK J:

But even if it didn't become untrue until the end, you shouldn't have allotted should you?

MR CARRUTHERS QC:

No, no.

GLAZEBROOK J:

Because you have to have a prospectus that is true and not misleading at the time of allotment and that's important because of finance companies that are allotting all the time and I think that was the context in which the continuous

disclosure came up because you have a prospectus that's out for the whole of period.

MR CARRUTHERS QC:
Yes.

O'REGAN J:
But then you have to exercise your rights under section 37A and your clients didn't do that.

MR CARRUTHERS QC:
Well there's actually probably quite an interesting argument about that as to whether there has actually ever been a certificate issued as to whether the time period has actually started to run.

O'REGAN J:
Well if you've still got the right you still have to exercise it.

MR CARRUTHERS QC:
No look I don't want to get drawn into that.

O'REGAN J:
Well that's quite important because in a way you're trying to turn section 56 into exactly the same remedy as 37A when you don't quality for that remedy because you didn't give notice in time.

MR CARRUTHERS QC:
No. The argument that I make under section 33 really is similar to the argument that arises under section 37 except there is a specific provision there that deals with the status of the offer in the sense that it is described as void. But I've still got a prohibition under section 33 and I've still got section 56 that if I sustain loss by reason of the untrue statement which arises as a consequence of the prospectus being issued in breach, being offered in breach of section 33.

O'REGAN J:

You should finish your argument.

ELIAS CJ:

I think this argument on section 37A and whether you're doing an end run around the restriction and that is really quite important but it may be that section 37A, the difference between that and section 56 is that there is no necessary loss in section 37A it's just a quick reversal.

O'REGAN J:

Well it's a cancellation, effectively; it's a cancellation of the contract.

ELIAS CJ:

Yes a cancellation and that it therefore doesn't affect a claim under section 57 and your argument on the but for consequence or the but for assessment of loss.

MR CARRUTHERS QC:

Yes, certainly the way in which I have analysed these provisions is that they each have their own discrete remedy. You've got 33 as the prohibition. You've got 37 with its mechanism under 37(4) and you've got 37A with the provision to give notice within 12 months of the certificate I think it is. So with respect I'm agreeing with Your Honour the Chief Justice but they are discrete matters. Now the remedy that arises under as a result of 33 is section 56 because the other two provisions have their own internal –

ELIAS CJ:

Well if you suffer a loss but you may not have any loss, you might still want to get out of the allotment.

MR CARRUTHERS QC:

Yes.

ELIAS CJ:

And section 37A permits you to do that if there's something in it, yes.

MR CARRUTHERS QC:

Yes. I think I was going to just the Court of Appeal judgment at paragraph 62 and 63 beginning really in paragraph 61 I expect where the Court of Appeal deals with the but for argument and my answer to the Court of Appeal at 62 is that there is an absolute prohibition in section 33 and in paragraph 63 my submission is that by reason of the untrue statement is in fact the fact that the prospectus is issued in breach of section 33 is the nexus to the loss by reason of the untrue statement. So that's the analysis I make. It is very much a but for argument. Now the last topic I want to deal with –

O'REGAN J:

Well it does seem odd though that it says, "By reason of the untrue statement," rather than by reason of the unlawful offer." It does seem to be focusing on a particular statement. The earlier – it talks about a prospectus containing an untrue statement and then it says, "By reason of the untrue statement" which seems to be referring back to whatever that untrue statement is doesn't it?

MR CARRUTHERS QC:

So on that sort of analysis one must say you have to identify the untrue statement and work out through the performance of the company what the effect was of the untrue statement ultimately on the business of the company. Now that can't be right of the context of –

O'REGAN J:

Well why does it say it, why does the section say it?

MR CARRUTHERS QC:

Well it's a question of how you actually interpret the section and what I'm submitting to you is the proper interpretation is that the loss by reason of the untrue statement is that the prospectus was issued in breach of – the offer

was made in breach of section 33. So you have, as a result of that you have a loss following on from the untrue statement.

O'REGAN J:

But the words "by reason of an untrue statement, of such untrue statement" that seems a bit of a stretch to say that means by reason of an offer being made in breach of section 33. I mean they're just two completely separate concepts.

MR CARRUTHERS QC:

But analysing the alternative really points back to the sense of interpreting that as a result of the untrue statement the losses suffered by reason of the untrue statement the losses suffered and how that all comes about is that the offer is made in breach of section 33. It all depends Your Honour, that's the way in the argument is put because to interpret it any other way means one would have to follow through the consequence of the untrue statement and tie to some sort of result. Now if one reflects on –

O'REGAN J:

But that's why section 37 completely sweeps all that away, 37A sweeps all that away and just says you can ask for your money back doesn't it? I mean that's the remedy but your clients have excluded themselves from the remedy. That's the obvious way to deal with this situation is to just say, "I want my money back" and if you don't do that you then fall into a much harder regime under section 56 which does require you to actually point to what caused you to suffer loss.

MR CARRUTHERS QC:

On that analysis, Your Honour, in the usual run of securities case you won't ever get a remedy.

O'REGAN J:

Well yes you will because you'll give it notice under section 37A.

MR CARRUTHERS QC:

No, no, no, I'm talking about under section 56 because what you're putting to me is that I must identify in the business of the company the effect of the untrue statement. Now that just cannot be the –

O'REGAN J:

Well you have identified the untrue statement.

MR CARRUTHERS QC:

I have identified the untrue statement but what you're putting to me is that I have to –

O'REGAN J:

No I think you can then say if the untrue statement hadn't been there the shares would've been worth $1.50 not a $1.70, so I suffered 20 cents loss, that's what section 56 is about. Section 37A is about getting your money back, section 56 is saying well that's gone now, you can't cancel the subscription anymore, we've gone past that point, so now we just look at well what was the difference in value between when I got and what I bargained for.

MR CARRUTHERS QC:

No, I mean you run into an immediate argument and the immediate argument there as to there's no market at the date the shares are allotted, so you're going to say it's a $1.70, $1.70 no loss.

GLAZEBROOK J:

Well you might say a notional investor wouldn't have invested in those circumstances – whole loss – or alternatively they would've invested but they would've invested at a lower price but I suppose at that stage there wasn't a choice about a lower price, so they wouldn't have invested anyway, so you probably, as you say, get to the same result.

MR CARRUTHERS QC:

Yes, and in answer to Your Honour Justice O'Regan, I do resist the concept that these are mutually exclusive. My argument is that they are discrete remedies and the fact that we haven't exercised section 37A does not mean we are disentitled under 33 and 56, and the interpretation I encourage in relation to 56 is to recognise it as investor protection legislation with the consequence that what should never have happened is retrieved by the remedy that's sought.

O'REGAN J:

But what's the point of having a time limit in section 37A if you go past the time limit and then claim exactly the same thing under section 56? It's just completely pointless having it, isn't it?

GLAZEBROOK J:

But you still have the shares issued though, whereas under 37A you don't have the shares issued so it's not totally wrong to have a time limit to say well it's too late to give your shares back but it's not too late to get your losses.

ELIAS CJ:

But I'm not so bothered about the "you've past the section 37A time" but I do think the existence of the remedy under section 37A may be a pointer against the but for approach to loss that you are urging in respect of section 56 but it still has to be tied to the untrue statement, a consequence of it. I mean you would say that, well you say that the investment was made and since the investment has been lost that's the measure of your damages.

MR CARRUTHERS QC:

Yes, yes.

KÓS J:

But in fact I think what you are saying is that the investor cannot, withstanding the time limit in 37A, come along to Court three or more years later and say, "I

wouldn't have invested in these shares so my loss is the investment," which is precisely the same remedy 37A provided but with a time limit.

ELIAS CJ:

But there may not have been any loss of the investment under 37A, it's totally –

O'REGAN J:

It's a cancellation.

ELIAS CJ:

Yes, it's a cancellation remedy.

O'REGAN J:

And it also makes different people liable. I mean under section 37A the issuer, in this case Credit Suisse Asia Pacific Partners would be liable whereas under section 56 it isn't because section 56 says an issuer is only liable if they are an actual person, so that affects the other defendants, doesn't it, because you would have thought Credit Suisse Asia Pacific Partners or whatever it's called would be the primary – given that it received the proceedings of the float – it would be the primary source of the remedy but it can't be liable under section 56 which puts all the onus onto the directors and promoters and so on.

MR CARRUTHERS QC:

I come to the point where there are the sections give three discrete remedies and I, while Your Honour the Chief Justice is saying to me that the time limit is a pointer against my section 56 argument –

ELIAS CJ:

Well no I don't think it is.

MR CARRUTHERS QC:

I beg your pardon.

ELIAS CJ:

I think the time limit is because I think that that's a cancellation out irrespective of whether you could say to have loss – you could show that there has been a loss but I think the existence of that return of your investment may bear on whether a but for approach to section 56 is available.

MR CARRUTHERS QC:

Yes, yes. I think I'm going to go over my ground again but my argument is that the prohibition in section 33 leads inexorably to the remedy under section 56 that means that we get the relief that we seek in relation to our subscription and that section 37 is a discrete remedy and section 37A is a discrete remedy and I think that's the argument I make.

ELIAS CJ:

You would not have invested but for the untrue statement which is prohibited and you can obtain as your loss, the loss of your investment because in this case the investment is lost.

MR CARRUTHERS QC:

Yes, that's right.

ELIAS CJ:

Whereas under section 37A it need not have been lost.

MR CARRUTHERS QC:

Yes, yes. So that leads to me to the final topic that I want to deal with and that is remedy because in the High Court and Court of Appeal, both Courts found against the analysis of loss that I have made and what happened in the High Court was that it also dismissed the appellant's claim for an enquiry as to damages. Now if I'm wrong on my analysis of loss on a but for basis and there are some basis on which loss should be calculated, I must be entitled to an enquiry as to damages on that basis and that presumably would be a matter that would go back to the High Court with a direction for an enquiry on some other basis for damages other than one that I have argued for.

O'REGAN J:

But your claim actually claimed the difference in value between the shares as issued and the shares as they should've been valued at given truth, so shouldn't you have proved them – shouldn't Mr Houghton have proved his case on that in the High Court?

MR CARRUTHERS QC:

Well no, in fact as I understand the way in which the case was run it was actually on the basis I have as a but for argument but with a request for an enquiry as to damages in the event that that argument failed. Because I mean otherwise in the High Court you will be really running contradictory arguments which presumably is why it wasn't run in the way in which Your Honour has indicated.

Your Honours, the topics that remain to be argued are first the issue of promoters and whether they were acting in their professional capacity and that was an issue that was left open by the Court of Appeal. The next issue that needs to be argued is this issue between stage 1 and stage 2 of the case and that's simply to clarify the way in which some of the findings of the Court of Appeal need to be dealt with and the third topic is really a miscellany of issues, of factual issues that arose in the Court of Appeal that we need to really clarify before Your Honours. Now those three issues are going to be argued by my learned friend Ms Mills. Just before I resume my seat though, can I just explain to Your Honour Justice Kós that putting to me that the forecast had been met for the 2004 year really assumes that what was done to achieve the figures was properly done and that's where some of those findings in the Court of Appeal need to be explained which my learned friend will do.

MS MILLS:

The Court of Appeal, at paragraph 264 of the judgment, the majority of the Court of Appeal considered the nature of the role played by the joint lead managers brought them within the definition of the promoters' definition in section of the Securities Act at paragraph 2(a) because they were –

GLAZEBROOK J:
I'm having just a slight – that might be better.

MS MILLS:
Sorry I'm so short.

ELIAS CJ:
Sorry, what paragraph are you referring to?

MS MILLS:
264. The majority considered that the nature of the role played by the joint lead managers brought them within the definition of promoter within section 2 paragraph (a) of the Securities Act because they were actively involved in the formulation of the plan to offer securities. The Court declined to consider whether the joint lead managers came within the professional services exception because the issue was not dispositive of this appeal and in the absence of full argument about the professional services exception would prefer not to express a concluded view.

The appellant asks this Court to rule on whether or not the professional services exception applies to the joint lead managers to keep them within the definition of promoter.

The Court of Appeal held that the definition is broader than the earlier definitions and there is nothing in the case law to suggest that a decision-making power is a necessary characteristic of a promoter, and that's recorded in paragraph 247 of the Court of Appeal judgment.

At paragraph 256 of the judgment the Court of Appeal held that taking that one becomes a promoter under sub-clause (a) by taking an active part in the formulation of the plan. At 264 they were actively involved in the formulation of the plan to offer securities. So they are able to shape the aspects of the offer and they were also able by the decision that the locking up of the shares kept them within the 2(a) definition.

ARNOLD J:

So in what ways did they shape the aspects of the offer? There was the dividend issue, was there anything else?

MS MILLS:

The lockup of the shares; they had the ability to require, to withdraw from being involved within the role as joint lead manager if they would not agree to the locking up of the shares for the equity incentive plan participants and as a result of this the Court of Appeal were correct – the majority of the Court of Appeal were correct – to hold that they were within the definition of a promoter under that section but then we turn to whether or not there is an exception under the section which requires them to be acting solely in their professional capacity. When they are acting for the directors or the company and the vendors they are acting in a professional capacity because they are advising and instructing and they are acting as professionals. However, when they are selling the shares they're salesmen and they are not acting in a professional capacity for the company or the vendor, they are marketing the shares for the sale, they are risk takers.

O'REGAN J:

The prospectus talks about Forsyth Barr Limited and First NZ Capital as being the joint lead managers.

MS MILLS:

Yes that's right.

O'REGAN J:

Is it the same entities that purchased or took firm allocations of the shares?

MS MILLS:

They are.

O'REGAN J:

Or was it sister companies?

MS MILLS:
Yes they are.

O'REGAN J:
It's the same entities?

MS MILLS:
The same entities.

O'REGAN J:
Because in one place it talks about First NZ Capital Securities Limited which seems to be a different entity from First NZ. Is that a partnership or something?

MS MILLS:
It's a partnership. So First NZ Capital is defined in the statement of claim as being an incorporated partnership.

O'REGAN J:
And it was the partnership that took the shares?

MS MILLS:
The partnership that took the risks. So the joint lead managers were underwriters of the priority offer to the bondholders, even though the prospectus stated at page 32 that the offer was not underwritten. That's page 32 of the prospectus. It gave the joint lead managers a significant interest in the successful outcome of the IPO. If they failed to encourage the bondholders to take up the priority offer, it would leave the joint lead managers with an underwriting liability.

They were also exposed to the risk when they agreed to take up the firm allocations. As Justice Dobson recorded in his judgment at paragraph 595, the decision to take up the firm allocation was to maintain the firm's client base. This is clearly a matter of self interest, maintaining the firm's client base

is not offering advice to Feltex and Credit Suisse, it is protecting their own interests in that is not acting in a professional capacity for the vendor and the issuer and the company. They're protecting their own position.

The joint lead managers were also conflicted between their obligations to their client base, many of whom like Mr Houghton relied on their advice or were put into shares via a managed portfolio private investments and the obligations to Credit Suisse to ensure that the IPO closed, taking a firm allocation and selling those shares to their client base cannot be acting in a professional capacity. It is the act of a broker, not a professional person as akin to their role of a real estate agent, they're a salesman.

Because taking firm allocations, underwriting and success fees are normal financial practices within the industry, that does not bring them within the scope of professional capacity in my submission. Just because this is a normal practice doesn't make it a professional practice. There is no independent advice when conflicts of interest arise. Bell Gully and Ernst Young were acting in their professional capacity as lawyers as accountants throughout the IPO and so are exempt. Investment bankers and brokers go one step further by actively promoting the IPOs as salesmen and are therefore not exempt. Their roles have an element of duality, that while they're acting professionally when advising Feltex and Credit Suisse by becoming risk participants, they are promoters in all senses of the word.

O'REGAN J:
Does that mean that any broker that takes a firm allocation is a promoter?

MS MILLS:
No because they wouldn't be a part of the formulation of the plan, they wouldn't come under (a).

KÓS J:

What your argument means is that every organising marketing participant is going to end up being a promoter because the securities market expects that that a broker will take some risk in relation to the IPO. So it's inevitable.

MS MILLS:

That may well be the case but that is the definition under the Act and there's no reason why the plain words of the statute should be departed from because following the *Hickman* decision we have a broad open statement which is part (a) and then you have the exemption under (c) which is the professional capacity exemption. So if you're acting as a professional you're exempt. So lawyers, accountants, bankers, auditors are exempt, brokers are not.

The other factor I would point out to establish that there was an element of acting in their own self interest as opposed to acting to advise and support the company and the issuers.

GLAZEBROOK J:

But where do you get the own self interest out of the definition?

MS MILLS:

Because they have to be acting solely in a professional capacity.

GLAZEBROOK J:

But it's to do with the professional capacity solely because I'm still quite interested in the first part of the definition to be frank.

MS MILLS:

In what particular way?

GLAZEBROOK J:

Well what it means to be instrumental in the formulation of a plan or programme because if you're – so you say they're instrumental because they

could stop or require something to happen, is that what I'm understanding? Because you in many capacities could be instrumental in the formulation of a plan, you could say here's my advice on what you should do and the promoters say, "It looks good to me" and in fact the promoters may not have a clue in fact what might look good or might not if you're looking at some of these issues because they're totally reliant on their advisers to tell them what the plan should be. I mean people who are floating don't know about marketing shares, they'll be reliant on advisers to tell them what to do won't they?

MS MILLS:
That's why they're instrumental in the formulation of the plan, they give the advice how to structure the offer, how to –

GLAZEBROOK J:
So anybody who gives advice on how to structure the offer is instrumental in forming the plan in the submission that you're making?

MS MILLS:
Yes, yes I am but I'm also pointing to the very –

GLAZEBROOK J:
Even if the actual promoter or the actual issuer can ignore that advice.

MS MILLS:
That is correct but in this particular case the joint lead managers required the lock up of those shares.

GLAZEBROOK J:
Well I understand that part of the argument but I'm just trying to take – so you don't take it – well you are taking it to the extreme if you give advice on a formulation of a plan, you're actively involved or instrumental in the formation of that.

MS MILLS:

So you've got to be actively involved, you've got to actually be doing something more than merely just saying I think this is a good idea or this a bad idea, this is about how you structure the offer, how you put together the prospectus, how you give the advice.

ELIAS CJ:

But where do you get "actively involved" – isn't the definition simply "instrumental" – so is that from case law?

MS MILLS:

That's from the Court of Appeal judgment, they use the phrase "actively involved".

ELIAS CJ:

Yes but I'm wondering where it comes from. Is there case law on this? Is there legislative history or anything like that?

MS MILLS:

There's legislative history on how various definitions of promoter go through the various stages but when we get to the Securities Act the definition changes and it has a structure which is to be followed as opposed to the broader definitions that were given in the earlier Acts. So I rely on *Hickman* in relation to how you interpret the Securities Act which you take the plain words of the statute, you look at them, you interpret them in terms of those plain words, there's no need to go beyond those plain words and then you take the next step and say how do we keep this from being too wide, well we say you've got a professional capacity, if you act within that professional capacity you are exempt from liability as a person who's part of the formulation, the instrumental end formulation of the plain. So it's that structure under the Act which defines who the promoter is. The fact that the words are wide and clear is limited by the professional services exception.

O'REGAN J:

But if you're a broker isn't it part of your profession to advise people how to do floats and to take underwriting commitments and so on, isn't that what your profession involves?

MS MILLS:

Yes it does but –

O'REGAN J:

So isn't that acting in a professional capacity?

MS MILLS:

Yes it is and I'm certainly not suggesting that those roles were not acting in a professional capacity but what I say is when they take the next step and market the offer to the public.

O'REGAN J:

Well selling shares is what brokers do, it's their profession.

MS MILLS:

Well, but you're not selling the shares, you're selling the shares in a capacity as a salesman as opposed to selling the shares – no that's not correct I'm sorry.

ARNOLD J:

Just so I can understand this, if we take the letter of engagement which is in volume 4 of the consolidated bundle I think.

MS MILLS:

Yes it's 22, 9164.

ELIAS CJ:

You've got it Justice Arnold?

ARNOLD J:

Well I've got a letter which I think is recording the terms of engagement, that's under tab 320, at 9158 in volume 4 of the consolidated bundle. So is that it?

MS MILLS:

Yes that's it.

ARNOLD J:

Right and when you look at the services provided, that will be provided set out on page 2 of that letter, the third point (iii) sets out a variety of roles. So you say that description brings you within the definition of promoter?

MS MILLS:

Yes I do.

ARNOLD J:

Yes and so then the questions becomes, whether that's part of a professional relationship.

MS MILLS:

There's a duality to the role of joint lead manager. They have obligations to the vendors and to the company and to the issuers but they also have obligations to the people to whom they sell those shares as well and so what I'm saying is that when they're selling shares they are doing it in a capacity as a salesmen to other people and the obligation is to both parties at that stage, so they're in a position –

GLAZEBROOK J:

But how does that take them outside of their professional capacity because surely when this legislation was being put forward, these types of roles were the professional roles that lead managers undertook in their professional capacity so why would their professional capacity be read in a different way than normally would happen in the market?

MS MILLS:

Because of the word “solely” in the definition.

GLAZEBROOK J:

Well in what other capacity are they acting in this case? Is that where the self-interest you say comes in?

MS MILLS:

That’s where the self-interest and the conflict comes in.

ELIAS CJ:

Because they took a firm allocation?

MS MILLS:

They took a firm allocation and if they didn't meet that firm allocation they were at risk of – they are risk participants as well – so they are taking a risk on the outcome of the IPO, they have to fund the shortfall and in fact Forsyth Barr did fund the shortfall and as a consequence they are in a position that they are not acting for the vendor, they are acting to protect themselves.

KÓS J:

You said before to Justice O’Regan that other brokers would not be caught because selling was what they did. Your answer was only if they were involved in shaping the offer.

MS MILLS:

That's right because to be a promoter you've got a two-stage process.

KÓS J:

Well if you deconstruct the three things the brokers were doing here, they were advising, they were underwriting and they were selling.

MS MILLS:

Yes.

KÓS J:

Individually each of those taken alone seems to be professional – something done in the professional capacity of a broker so how is it that wrapped up together in combination that changes and they become a promoter?

MS MILLS:

Well it doesn't, it's not wrapped up together, they are separate stages and I am saying that the act of selling is not acting in a professional capacity because they are actually selling to other people and they are in a position of conflict.

KÓS J:

But if they hadn't had the other two functions, your answer to Justice O'Regan was that wouldn't amount to promoting.

MS MILLS:

Being a promoter, that's right, because people who have taken a firm allocation haven't been involved in putting together the prospectus and promoting it and being instrumental in the creation of the plan are not promoters because they don't come within the first broad definition.

ELIAS CJ:

You're relying on the cumulative definition?

MS MILLS:

I'm saying that first of all you've got to be instrumental in the formulation of a plan.

ELIAS CJ:

Yes that's what I mean. They have to be instrumental and if they are and they're not acting solely in a professional capacity then they're promoters.

MS MILLS:

Then they are promoters.

GLAZEBROOK J:

But if you're allowed to underwrite and sell if you haven't advised then that must be in your professional capacity and there would be a conflict there.

MS MILLS:

Well no because –

GLAZEBROOK J:

Well why isn't there a conflict? Sorry, no, because you're saying that they're not acting in the professional capacity because there's a conflict?

MS MILLS:

Because they are not acting for the vendor when they are taking the firm underwrite.

GLAZEBROOK J:

Well they could be acting for the vendor.

MS MILLS:

Well we haven't pleaded that, we haven't pleaded that the other people –

GLAZEBROOK J:

I'm sorry, what I'm suggesting is it's only if it's advising, underwriting and selling on your analysis that means they are not acting solely in a professional capacity and in fact they wouldn't come within the promoter at all if they didn't advise if they were merely underwriting and selling they wouldn't have come within the definition of promoter?

MS MILLS:

That's correct.

GLAZEBROOK J:

And then you say, however, that if they have a conflict they're not acting in their professional capacity but an underwriter and seller will have a conflict,

won't they, ie, they will want to sell as much as much as possible because otherwise they will have to fund the shortfall.

MS MILLS:
That is correct, they would, but because they are not part of the first definition they are not a promoter.

GLAZEBROOK J:
But then if you say that they are not acting in their professional capacity by underwriting and selling because they've got a conflict.

MS MILLS:
What I'm saying is the act of –

GLAZEBROOK J:
I mean they're not lawyers, they are allowed to have conflicts, aren't they?

MS MILLS:
Well they certainly are but the point that I'm trying to make is that the act of selling is not a professional capacity it's a salesman, it's an investment banker, it's a –

GLAZEBROOK J:
It's a broker, that's what they do.

MS MILLS:
It's a broker.

GLAZEBROOK J:
But that's what they do so if it's not in a professional capacity what else do they do?

MS MILLS:
Well –

KÓS J:

They've done that since Mr Lloyd opened his coffee shop.

MS MILLS:

I'm sorry, I missed that Your Honour?

KÓS J:

They've done that since Mr Lloyd opened his coffee shop, they've sold shares, that's what they do, then they became advisors but the selling came first.

MS MILLS:

Yes, so I'm not disagreeing with Your Honour, I'm saying that the act of selling shares would go with it, the obligation to give professional advice to the person to whom they're selling shares. The ways in which you can sell shares through the NZX, for example, is you can list your shares for sale and there is no communication between people and people can come in and elect to take the shares but this is an IPO, this is not an NZX listing situation, what we have now is a broker who is part of a plan, who has been instrumental in the formulation of the plan, who is marketing the shares for themselves not for the vendor because they've got a risk.

ELIAS CJ:

The definition actually isn't cumulative really. The cumulative thing is at paragraphs (a) and (b) and the exemption applies whether you're under (a) or (b). So if you acknowledge that a broker is acting in a professional capacity if he deals in shares, that's the end of the story isn't it?

MS MILLS:

Well no because when a broker acts in a professional capacity through listing the shares of the stock exchange, then he is acting in a professional capacity because they're listed, it's an open market, people can make decisions one way or the other and buy the shares or not buy the shares. This is a different situation because this is an active role in selling, going to the market and saying, "Buy these shares".

ELIAS CJ:

All right, well I think we understand the argument.

MS MILLS:

Right, thank you. The next point I want to deal with is the stage 1, stage 2 trial argument. It will take a bit of time and I see we've got four minutes or three minutes left to go.

ELIAS CJ:

Sorry I didn't take a note, what topic are you addressing now?

MS MILLS:

What I'm addressing now is what are the common and non-common issues and whether there should be a stage 2 trial.

ELIAS CJ:

Oh I see, yes.

GLAZEBROOK J:

That's different from the enquiry into damages or related to it?

MS MILLS:

It's related to it but different.

ELIAS CJ:

All right, well it's probably sensible to take the adjournment before you get under way with that.

COURT ADJOURNS: 12.57 PM

COURT RESUMES: 2.15 PM

MS MILLS:

These proceedings were brought in the High Court as representative proceedings. They were filed in Christchurch by the appellant in respect of this personal claim and also in a representative capacity.

On the 1st of August 2012 Her Honour Justice French delivered a judgment giving directions as to the conduct of the trial. Those orders are found in her decision which is tab 38 of the appellant's bundle. And as recorded at paragraphs 39 and 40 of the judgment the outcome was, "There will be a stage one hearing at which Mr Houghton's claim is to be heard in its entirety." At paragraph 40, "Rulings at the stage 1 hearing on common issues, identified in Mr Cooper in his list of 20 January 2012, will be binding as between all other members of the representative class and the defendants."

When one goes to the list of the 20th of January filed by my friend Mr Cooper, that is found at tab 31.

ARNOLD J:
Sorry, tab what?

MS MILLS:
31.

GLAZEBROOK J:
Of what?

MS MILLS:
Sorry, the consolidated bundle.

GLAZEBROOK J:
Okay, which is volume 1.

MS MILLS:
Sorry, no, my junior has pointed out that this is actually in the original bundle that was filed at the beginning in the case on appeal, the hardcopy bundle, which includes all the judgments, all the rulings, all the –

ELIAS CJ:

I think that might be volume 3, is it? That's the one that's got the judgments in anyway.

MS MILLS:

It's not in the consolidated bundle, Your Honour, it's found in the –

KÓS J:

Is this the memorandum of counsel?

MS MILLS:

Yes it is.

GLAZEBROOK J:

Case on appeal volume 2 or 3.

O'REGAN J:

No it's the blue one.

ELIAS CJ:

It's the same as the Court of Appeal judgment. So that's where the reserved judgment of Justice French is, sorry, what's the thing you are now referring us to?

MS MILLS:

I'm referring you to the list of the 20th of January which is the memorandum of counsel for the first defendants regarding common issues.

ELIAS CJ:

Sorry, what tab is it?

MS MILLS:

It's at tab 31, Your Honour. In this memorandum Mr Cooper has set out all the factual matters that are agreed to be common issues and those are the

common issues that Justice French has ordered will be binding on all parties including the representative claimants.

Attached to the list is a schedule which sets out which of the pleadings are common issues and which of the pleadings are not. The matters that were not included as being common issues, in other words, non common issues and therefore not binding on the represented claimant group is whether a statement in the prospectus is misleading –

GLAZEBROOK J:
Do you want to just tell us where those are that are not binding?

MS MILLS:
You have to go through each one of these paragraphs of the statement of claim.

ELIAS CJ:
But presumably you're taking us to ones that bear on the point that you're –

MS MILLS:
Well the matters which are excluded – which aren't included – are whether the prospectus was misleading.

ELIAS CJ:
Sorry just tell us where that is.

MS MILLS:
Well it's not there because it's not in the list.

O'REGAN J:
So it's a common issue, so we're now talking about ones that aren't here.

GLAZEBROOK J:
So is that from the statement of claim then? So what paragraphs of the statement of claim aren't in there?

MS MILLS:

The pleadings as to reliance, causation and loss.

GLAZEBROOK J:

All right.

MS MILLS:

And actual and misleading conduct in respect of each investor and compensation under section 43 of the Fair Trading Act.

GLAZEBROOK J:

So reliance loss and what else did you say sorry?

MS MILLS:

Reliance, causation and loss.

ELIAS CJ:

And the Fair Trading Act causes of action?

MS MILLS:

Yes that's correct but only as actual misleading or deceptive conduct.

KÓS J:

Just help me Ms Mills, where in your written submissions are we?

MS MILLS:

Right at the very beginning, page 1. And the other item that was identified as not being a common issue was actual reliance, whether a statement in the prospectus was misleading to an investor in respect of section 55 of the Securities Act. So those are the items which are not common issues. The appellants' stage 1 trial was conducted by the appellant in accordance with the judgment of –

ELIAS CJ:

So where's the order as to what's to be covered in the stage 1 trial? Is there one?

MS MILLS:

Yes that was the order that I took you to.

GLAZEBROOK J:

Because I couldn't find it at the time because I wasn't sure where you were. So perhaps go back to the order.

MS MILLS:

The order is the 1st of August.

GLAZEBROOK J:

Yes and where is it? I have actually read it before.

MS MILLS:

And it's at paragraph 39 of the Judgment, tab 38.

GLAZEBROOK J:

So paragraph 40?

MS MILLS:

39 and 40. At the hearing of this particular application Mr Forbes had applied to include additional questions which may have been of assistance to the Court and that application is declined at paragraph 41. So the trial was to be conducted at the stage 1 trial only on Mr Houghton's claim and in respect of the common issues not to the non-common issues. To the extent that evidence was called on non-common issues, those were not binding on the complainant group.

The respondents called evidence as to loss which was Professor Cornell's evidence which went well beyond the agreed scope of the stage 1 trial in that

the identified purpose of which was to address the loss suffered by Mr Houghton personally, not every single claimant group. So the findings as to loss, it is submitted, that are found in the Court of Appeal judgment are not binding on the claimant group.

O'REGAN J:
But wouldn't every purchaser of shares suffer the same loss?

MS MILLS:
No because depending on whether or not there is a determination as to a tortious quantification of loss. Some people would have suffered more or less because they would have sold on market after the purchase issues.

O'REGAN J:
On the but for example obviously everybody suffered the same loss.

MS MILLS:
Everyone suffers the –

O'REGAN J:
On the difference in value or wouldn't it be the same? The value assuming a compliant prospectus versus a value as to what people actually paid.

MS MILLS:
That would be the same but of course some people sold on market and other people held to the end of the company until it went into liquidation.

O'REGAN J:
But if you're talking about a difference in value you measure that at the time they bought them.

MS MILLS:
Yes but then they'd have to set off what they'd recovered.

O'REGAN J:

Yes, but that's just mathematics though, isn't it?

GLAZEBROOK J:

But some people might be able to say I wouldn't have entered into it –

O'REGAN J:

Yes but that's but for, I mean that's still the – if everyone says that they get the same amount.

GLAZEBROOK J:

Well, no, they would but some people wouldn't be able to say they wouldn't have entered into it because they'd say, "Well I would have entered into it but I might have sold a bit earlier," but I suppose conceivably if the respondents are right there will be some people who say I wouldn't have entered into it and if they managed to prove that then they would actually have the whole loss.

MS MILLS:

Yes, and there will also be people who would have said, "Well if I'd known about the untrue statement I would have only paid 50 cents for the shares, so we have those sort of arguments on loss that need to be dealt with at a stage 2 trial.

KÓS J:

Why does this issue concern us? Because?

MS MILLS:

Because the finding in the Court of Appeal that there is no right to a stage 2 trial.

O'REGAN J:

There is what, no?

MS MILLS:

No right to a stage 2 trial.

KÓS J:

Just show us that paragraph, where's that again? It's paragraph 33 isn't it?

MS MILLS:

Paragraph, I don't think it's 33 Your Honour.

KÓS J:

Unless Mr Houghton is successful on appeal there will be no need for the second stage of the hearing. That's the passage?

MS MILLS:

That's the passage.

KÓS J:

33.

GLAZEBROOK J:

That's only just saying that he hasn't succeeded on showing a material mis-statement isn't it?

O'REGAN J:

That's talking about successful on the Court of Appeal appeal, so it's saying based on the High Court finding that there wasn't misleading statements you don't need a second trial, that's just a statement of fact isn't it?

MS MILLS:

No. It may be a statement of fact but the issue is that the findings of fact within this judgment are about reliance, causation and loss and as a result there's been a finding that there is no need for a stage 2 trial.

O'REGAN J:

The High Court found there wasn't any misleading statement.

MS MILLS:

The High Court found that yes.

O'REGAN J:

And this is saying if Mr Houghton doesn't displace in the Court of Appeal there won't be a second trial.

MS MILLS:

Yes but we've got a finding of an untrue statement.

O'REGAN J:

Yes I know but paragraph 33 isn't dealing with that, paragraph 33 is a prelude to the Court of Appeal finding.

MS MILLS:

Yes.

O'REGAN J:

So what does the Court of Appeal say after it's made its judgment, what does it say about the stage 2 trial then?

ELIAS CJ:

It's the Court of Appeal determination that it wasn't causative of loss.

MS MILLS:

Yes.

ELIAS CJ:

You say that it was premature for the Court to enter into that because that was to be the subject of stage 2, is that right?

MS MILLS:

That's correct.

GLAZEBROOK J:

But not for Mr Houghton which is all they're saying.

MS MILLS:

That's correct.

GLAZEBROOK J:

At 310, so they just said he needed to prove evidence to substantiate the loss.

ELIAS CJ:

Well is there anything wrong with that, 310? You're not complaining about that?

MS MILLS:

I'm not complaining about it to the extent that as the Court finds that there has to be a tortious calculation as to loss, then Mr Houghton has no right to a stage 2 trial but the other complainants are entitled to a stage 2 trial because they are entitled to call their own evidence.

ELIAS CJ:

But this judgment doesn't deal with them, except in respect of the common issues, does it?

MS MILLS:

Well it does actually. If I could go through my submissions, I'll take you through what they're saying because in fact –

ELIAS CJ:

So where are you in your submissions then?

MS MILLS:

I moved from my opening submissions as to what the outcome was in Justice French's determination to paragraph 112 of page 24 of my submissions. So my submission is that having established the untrue statement for the purposes of section 56 of the Securities Act and misleading for the purposes of section 9, findings of fact by the High Court and the Court of Appeal in respect of reliance, causation and the loss are not common

issues and therefore do not bind the representative qualifying shareholders. In respect of reliance the Court of Appeal introduced an objective test at paragraph 69 of the judgment. I'll just take Your Honours to that particular finding.

ELIAS CJ:

How could the – I'm just trying to work out how on earth court the Court deal with your appeal without expressing views as to the correct approach?

MS MILLS:

Well I'm not suggesting that they shouldn't but what I'm suggesting is that if there are findings, legal findings as to how to interpret a particular part of the statute, then those particular findings are not binding on the representative class if they can –

GLAZEBROOK J:

But would be the point if it's an objective test on coming along and saying, "I think it should be interpreted differently for me because it can't be if it's an objective test? It mightn't be binding on them in terms of res judicata but it would sure be binding on them in terms of the Court not going to change its mind from day one to day 10.

ELIAS CJ:

They'd have to appeal here.

MS MILLS:

Well the point that I'm trying to make is that they're entitled to call the evidence, the factual evidence to support whether or not a notional investor would've invested if they'd known the true position.

ELIAS CJ:

Well is it being suggested that they wouldn't have that opportunity if there are factual determinations to be made?

KÓS J:

And isn't that a question for the trial Judge, not this Court?

GLAZEBROOK J:

Well the respondents may be arguing because they did certainly argue at one stage there wasn't a second stage, so maybe it's worth waiting till reply to see if they're still maintaining that in terms of – because your argument is that they should be able to call evidence to say whether that objective test was met or not.

MS MILLS:

Yes and whether or not –

GLAZEBROOK J:

That's if we uphold the objective test I suppose.

O'REGAN J:

But the point you make at 113 is that's a finding that the statement isn't material isn't it? That's a generic finding that will be binding on everybody.

MS MILLS:

Whether it's material?

O'REGAN J:

Yes.

MS MILLS:

Well that of course is the argument that has been put by my learned friend Mr Carruthers.

O'REGAN J:

No I know that I mean but I know there's a whole argument about that but let's just assume the Court of Appeal is right for a second, that is a generic finding that binds everyone, isn't it?

MS MILLS:

Yes they would have to establish that – bring their own evidence as to whether a notional investor –

O'REGAN J:

Well no because the Court of Appeal is talking about the prudent non-expert investor that the Securities Act refers to. That's a generic objective standard it isn't something to do with the individual investors. So it's saying is it misleading to a prudent non-expert investor that –

GLAZEBROOK J:

I think the argument is that they might be able to bring other evidence to show that it would be misleading, as I understand the argument.

MS MILLS:

Yes, that is the argument.

GLAZEBROOK J:

So the evidence that wasn't brought by Mr Houghton.

MS MILLS:

Mr Houghton brought only the evidence that applied –

O'REGAN J:

But this is deciding the legal issue of was this statement a material statement.

ARNOLD J:

And the Court does say at 116 in the last sentence, "The Judge had a proper evidential basis for its finding that the notional investor would not regard that shortfall. So wouldn't you just be traversing exactly that ground again?

MS MILLS:

No what we've been traversing would be the evidence that the claimant group would rely upon to establish what the loss actually was and what would've affected the notional investor because the evidence that Mr Houghton put

forward was what affected him as an investor because it was a trial about what he was doing and the decisions he made.

ARNOLD J:
Well it's perhaps not worth pursuing this but the notional investor is an objective standard, not a subjective one.

MS MILLS:
That's correct.

ARNOLD J:
And if that standard is right, you look at what this construct would not have done.

MS MILLS:
That's right.

ARNOLD J:
Right, well that construct applies whatever any individual subjectively might have done, that's the whole point of it.

MS MILLS:
That's correct but I'm not talking about subjective –

ELIAS CJ:
You're talking about different objective evidence.

MS MILLS:
That's correct.

ELIAS CJ:
Yes.

MS MILLS:
So I'm talking about the right to –

ELIAS CJ:

But that's all hypothetical at the moment isn't it? That case is not before us and if it's to be run for the represented litigants, then the stage 2 that has been reserved to them by the procedural hearings, won't that be the occasion to run it and if necessary, because if you find that the Court of Appeal legal determination stands in your way you'll have to have a leap frog appeal here on that point.

MS MILLS:

I think that is the point that my friends have raised in their submissions. My point is that having had these procedurals rulings made, a trial was conducted on a particular basis and the Court of Appeal have said there will be no stage 2 trial.

ELIAS CJ:

Well I don't read the Court of Appeal as saying that and surely if you're saying it depends on evidence at stage 2 going to the objective position, you call that evidence, you make the submission that actually things are different because of this evidential foundation. If the Court doesn't accept that submission, then you'll have to appeal won't you?

MS MILLS:

Yes.

ELIAS CJ:

Well it just seems that really this is not before us at the moment Ms Mills. What are you seeking from us?

MS MILLS:

I'm seeking a ruling that we're entitled to a stage 2 trial for the claimant group.

ELIAS CJ:

But you got that and that's not something of which we are seized, that you have a ruling that there is to be a stage 2 trial, except on the common issues.

MS MILLS:

That's right, just on the non-common issues which are reliance, causation and loss.

O'REGAN J:

But it's also going to depend on what the outcome of this appeal is isn't it?

MS MILLS:

Yes it will.

O'REGAN J:

So it's a bit pointless us trying to judge that in advance.

MS MILLS:

Well I certainly took the view that the judgment itself precluded the stage 2 trial.

ELIAS CJ:

Well what are you referring to in the judgment which precludes your going on with stage 2 if you get to that point?

MS MILLS:

If I can just find the actual finding.

GLAZEBROOK J:

Well is it no more than logically under the Court of Appeal decision because it wasn't material there'd be no stage 2 trial because the objective observer, objective notional investor wouldn't have been affected by it and then you're only argument is that people should be able to put up other evidence to show that the notional investor would've been affected by it?

KÓS J:

Well because they came from different contexts perhaps, so the underlying context might differ.

MS MILLS:

Yes, that is my submission.

GLAZEBROOK J:

All right, because even though it's not a common issue the Court of Appeal certainly is not going to change its mind on the test is it no matter what evidence is given?

MS MILLS:

No.

GLAZEBROOK J:

Well at least it would be very embarrassing if they did do that in such a short time.

MS MILLS:

So those are my submissions in respect of the stage 2 trial, the request for a stage 2 trial. So I'd like to now turn to the issues, peripheral issues that are covered in my submissions and the issues where I say the –

ELIAS CJ:

Are these the ones that are under the heading of "subsidiary issues"?

MS MILLS:

They're subsidiary issues because they don't really become relevant unless we get to the position that there was an untrue statement and that there were material – the requirement for material information is provision of the requirement for material information has not been satisfied.

I start at paragraph 127 of my submissions. At paragraph 110 of the judgment the Court of Appeal found that the offering of extended credit was not a new practice and consequently did not at paragraph 109 of the judgment did not distort the FYO4 sales results. With respect these findings are incorrect. The

Court has confused the practice of forward dating of invoices with extended credit sales and that confusion is noted at footnote 67 of the judgment.

The evidence of Mr Tolan regarding the forward dating of invoices is found in his brief of evidence which is 9/3672 and that is at tab 149 of the bundle, of the first bundle. Not the consolidated bundle because – oh it is in the consolidated bundle I'm sorry and so it's at paragraphs 109 to 118. At 119 he explains the role promotions which gave extended credit terms of 60 to 90 days. He advises that the role promotion invoices were not forward dated and neither were bill and hold transactions which are further types of transactions and these were referred to as extended credit sales.

Under cross-examination Mr Tolan at ECO18 3771 at page 3955 which is – so that's tab 153 at page 3955. So I'm referring to the cross-examination that I carried out against Mr Tolan and I put to him that the 8 April presentation of 2004 had a strategy in it. He was asked, "So what were these extended terms that were offered?" So at the bottom – no that's not right. I'm just going to ask my junior to actually find the correct reference, it would appear that it's been hyperlinked incorrectly.

ELIAS CJ:
So what's the submission that you're wanting to make here while we're finding the place?

MS MILLS:
My submission is that extended credit terms were not the same thing as forward dated sales.

ELIAS CJ:
Well I'm inclined to agree with that but why do we need to go to the evidence on it?

MS MILLS:

Because the Court of Appeal have found that forward dated sales and the extended credit terms were the same thing and because they were the same thing they didn't distort the sales. So I need to then take you through the process of the evidence that was addressed and in particular the evidence of Mr Tolan, "So what were these extended terms that were offered?" And he says, "There were no, well we hadn't identified exactly in the presentation", he's referring to the 8 April 2004 presentation which included all the prospective financial information that was presented to the Board. "We hadn't identified exactly in the presentation those extended terms but there would be various extended term programmes put in place to encourage sales." So I'm saying the extended credit terms, extended credit sales, it's found the correct page sorry, it is at 3878. So we've got an admission from Mr Tolan.

ELIAS CJ:

So where is it? Can you just tell us what the question is and we'll try and find it.

MS MILLS:

So it's 3878, my question is, "So what were these extended terms that were offered?" "There were no, well we hadn't identified exactly in the presentation."

O'REGAN J:

It's the very last line.

MS MILLS:

"Those extended terms but there would be various extended term programmes put in place to encourage sales." So I'm therefore that the Court of Appeal were wrong in their finding that forward dated sales and extended credit terms were the same and then I then go to Mr Magill's evidence where he describes the usual terms of trade and explains the difference between forward dated invoices as opposed to how they work, how forward dated

invoices worked but the important and crucial evidence is the evidence of Mr Cameron at 12/4908 which is tab 180.

ELIAS CJ:

This is not the consolidated bundle though is it?

O'REGAN J:

So this is the cross-examination of Mr Cameron is it?

MS MILLS:

Cross-examination of Mr Cameron and it's at line 11. So once again I'm putting to him the 8 April presentation and the strategy that was noted in the 8 April presentation that to reinforce some growth strategy and to encourage the movement of business from our competitors we will offer extended terms for the sales growth. And then the next question is, "And there was a new strategy as opposed to what Mr Tolan was saying was a strategy prior to this IPO period, you can see that? Yes. So this is an increase in extended credit terms? Yes." Under cross-examination at 11/4730 of Mr Horrocks.

KÓS J:

At paragraph 131 of your submissions, you're just going through those aren't you? The reference is there.

MS MILLS:

The references are all there. So there's been an extension in credit terms in the last three months of FYO4 which resulted in a higher receivable balance at the end of June 2004 and the extended credit obtained in the last three months of FYO4 was in the region of $10,291. So I can take you to each one of those documents if we need to see them but you can see there has been a blowout, an increase of extended credit and that distorts your sales results because we've got a three month period in the forecast, we've got increased extended credit sales of $10 million and yet we've got a significant shortfall in sales without those extended credit sales and there was no disclosure of this

intention to increase extended credit sales in the prospectus, nowhere was there any discussion about it.

O'REGAN J:
So is that an argument that we should be overturning a finding of fact in the Courts below about this?

MS MILLS:
Yes you should be. It certainly should be taken into account when assessing the importance of the untrue statement which was as to the revenue generated in the financial year because we've got $10 million worth of extended credit sales dumped into the final quarter to reach the sales figures that they are attempting to reach and yet they still fail to meet that target, so it's an important issue the extended credit sales.

O'REGAN J:
But it's important in what context? As a standalone point or as support for the point that Mr Carruthers was making this morning?

MS MILLS:
As support for the point that Mr Carruthers was making and it also challenges the finding that the sales results were close to being achieved so that the failure to meet those sales result was not material. If you don't disclose that you've blown out your credit sales to your investor in that period, how can they make a value decision to invest? How could a notional investor make that decision when there has been an increase in credit sales?

KÓS J:
The respondents say that this is a point that you didn't take on appeal to the Court of Appeal, this is the submissions at paragraph 24. So they say that you've leapfrogged the Court of Appeal to this Court on this particular point. What do you say about that?

MS MILLS:

I'd have to discuss that with Mr Carruthers because my recollection is that we did and if you we could deal with that in reply perhaps.

KÓS J:

Well it's the written submission that's in front of you from the respondents.

MS MILLS:

As my friend just pointed out, there wouldn't have been the finding at footnote 67 if we hadn't argued it.

ELIAS CJ:

Footnote 67 is referred to again later in judgment 2 isn't it? I must say I flagged that because it seemed extraordinary to me and I think it's at the very end isn't it? But in 312 the Court of Appeal says, this is the forward dating of invoices, that all counsel had been agreed it wasn't determinative of any aspect of the appeal.

MS MILLS:

Sorry where's that?

ELIAS CJ:

312.

MS MILLS:

Of the judgment? That's about failure to disclose work product. So that's got –

ELIAS CJ:

Well they're talking about the practice of forward dating of invoices and the extent of that practice.

MS MILLS:

No the point that was taken on appeal was the complaint made by Justice Dobson that the appellant had failed to disclose its work product when

assessing the forward dating of sales and that was the appeal point that was raised and not the issue about whether or not there had been extended credit terms offered. So that's about the analysis of what was called the GSM data.

ELIAS CJ:
Oh I see, okay.

MS MILLS:
And the GSM data was done –

ELIAS CJ:
That's all right, if it's irrelevant don't worry about it.

MS MILLS:
It's a very different point. I then note that at paragraph 111 of the judgment the Court of Appeal found that actual figures for the third quarter to March 2004 were included in the prospectus and showed very positive variances at the same point in time in the previous year. That finding is also incorrect. The actual figures in the prospectus were the figures to December 2003 and are found at pages 81 and 82 of the prospectus. It's only by reference to Mr Tolan's PFI spreadsheet that the actual figures for the third quarter to March 2004 can be found and it is that spreadsheet which also sets out the analysis of the prospectus financial information that was included in this prospectus. The margins were never disclosed in the prospectus. So in making that finding the Court of Appeal erred in relying on that particular statement to substantiate the materiality argument about the untrue statement.

My learned friend has already addressed you about the spreadsheet and graphs so I won't go over that again but I would like to deal with the issue of management incentive programmes, MIP, and the effect that MIP has on the achievement of the result which was relied upon as being, as establish that EBITDA and NPAT were achieved in March 2004.

At paragraph 107 of the judgment the Court of Appeal found that the shortfall in sales in FY04 would not result in shortfall in EBITDA and NPAT. This was due in part to the success of a strategy of changing Feltex's product mix away from lower priced and lower margin products in favour of higher priced and higher margin product. In other words what was important to the company's performance not only how much carpet was being sold but what type was being sold. Feltex could make more profit from lower total revenue to the right mix, with the right product mix and although Feltex sales revenue increased by 3.9 per cent from FYO3 to FYO4 over that same period the margin earned on sales increased by 13.3 per cent. I make the point again that margins were never disclosed in the prospectus.

KÓS J:

So you're at paragraph 121 of your submissions?

MS MILLS:

121, I am. And I also make the comment that although there was an increase in sales revenue from financial year 2003 to financial year 2004 of 3.9 per cent it was supposed to be over 7 per cent increase so that is why the annualised figure becomes important because that is a significant lack of increase that was projected.

O'REGAN J:

Isn't the point just that the figures that were actually achieved, vis-à-vis the figures that were forecast were higher in relation to EBITDA and NPAT even though they were lower in relation to revenue – isn't that just a matter of reporting the historical facts?

MS MILLS:

It is a matter of historical facts but one has to look to see how that was achieved. How did they manage to lose sales and still achieve EBITDA and NPAT and we say there were two ways in which they did that, one was the extent of credit sales method of –

O'REGAN J:

But if they forecast it and then they achieved it doesn't that mean the forecast is an accurate forecast?

MS MILLS:

No because one has to look at what else was done to achieve it and one of the things that was done was the reversal of MIP. To drive the result for the management incentive, to drive the result for the EBITDA and NPAT they had to reverse MIP and if I could take you to –

O'REGAN J:

Well hang on I thought we were talking about the extended credit at the moment. Is this a different point?

MS MILLS:

No I've moved from extended credit onto MIP which are two combined concepts.

KÓS J:

So you said there are two things that enable them to achieve the result. One of them was the forward sales policy.

MS MILLS:

Yes.

KÓS J:

What was the second?

MS MILLS:

The removal of MIP. So if I could take you to document 318 which is volume 22 at 9155. Now this is a hardcopy PDF version of – this is Mr Tolan's spreadsheet which he created for the forecast and projections for the PFI which were taken into page 85 of the prospectus and when one looks at this particular document which is the document which was relied upon to produce

the prospectus, you'll see that down the left-hand side there's a whole series of descriptions of how the information was put together and it says, “EBITDA before MIP” and that is the figures for that and “EBITDA after MIP”, so that it was included in the financial, the PFI, that there would be MIP payable on the forecast sales to the management staff of $2,273,000. I then take you to Joan Withers’ exercise book which is included in the –

GLAZEBROOK J:
I’m sorry and where do we get that from?

MS MILLS:
If you look at the line, if you want to see the XLS spreadsheet, it’s probably easier to read, it’s just that this is a hardcopy printed one for the bundle.

ELIAS CJ:
Yes but where are you –

O’REGAN J:
Where does the figure that you just gave us come from?

MS MILLS:
It comes from MIP, if you look on the left-hand side there's EBITDA before MIP, management fee CFSB, MIP which is two million and on the right-hand side the total for the year.

O’REGAN J:
So it’s the 2273 figure, is that the one you're referring?

MS MILLS:
That’s right. And so then the bold number under there is the anticipated EBITDA after the payment of MIP. So when preparing the PFI material it was always intended that they would pay the management incentive payments, even though the management had failed to meet the budget to 31 March 2004.

O'REGAN J:
Sorry did you say "Even though the management hadn't…"?

MS MILLS:
Had failed to meet the budget. They were still going to be paying their MIP even though they'd failed to meet the budget. So included in the PFI material was an expense line of MIP of $2.273 million.

So then when one goes to Joan Withers' exercise notebook where she took very detailed notes of what was going on and what she needed to know and that is tab 329 and commencing at page 9370.

ARNOLD J:
Sorry, did you say tab 329?

MS MILLS:
Yes I did.

KÓS J:
I don't think we've got that.

ELIAS CJ:
No we haven't.

GLAZEBROOK J:
What page was it?

MS MILLS:
I'm surprised it's not in the bundle. It was certainly referred to in my submissions and hyperlinked to the electronic bundle.

GLAZEBROOK J:
Well do you just want to give us a page number?

MS MILLS:

Yes, it starts at 9370 and these are her notes about the board papers.

ELIAS CJ:

No we don't have it. We go from 9345 to 9385.

GLAZEBROOK J:

We can get it electronically.

O'REGAN J:

Do you just want to give us the page numbers and we'll get it tonight and print it out from the electronic one.

MS MILLS:

I can certainly provide hardcopies for you tomorrow.

ELIAS CJ:

Well we can print it out.

O'REGAN J:

So what's the page you're referring us to, 93…?

MS MILLS:

93 – these are her notes of the 22 June '04 meeting. This is the –

O'REGAN J:

The 22 June?

MS MILLS:

22 June '04 meeting where the explanations are give as to how they've managed to achieve their, how they are going to manage to achieve their results as at 30 June 2004. So the first page –

GLAZEBROOK J:

Can you give me the page number again, I missed that?

MS MILLS:

9370. The first page of the document is at 9347, so it's a substantial document that looks like this. These are their note – an exercise book that Joan Withers put together to recall her findings and her investigations into the management of Feltex. And at page 9371 which is the page which actually deals with MIP she records that the reversal of MIP drives the EBITDA result for the forecast and she also records that before MIP EBITDA is $2.3 million below forecast.

So to meet the EBITDA lines in the financial reports they had to reverse MIP when that was a line that was included in the PFI and it's always anticipated that it would be included.

KÓS J:

I tell you what's worrying me, Ms Mills, you're giving us an interesting accounting analysis of these accounts but where are the references to what first your expert said on these points, rather than you and secondly, what was put to the witnesses, respondents in cross-examination because frankly they have more significance? With respect, I do mean that.

MS MILLS:

Well with respect as well Your Honour, it's important to look at the documents as opposed to the oral evidence given by people who had limited recollection of what actually went on.

KÓS J:

Well I want to know that there was oral evidence and I also want to know that there was expert evidence.

MS MILLS:

There was oral evidence in respect of Ms Withers. She was cross-examined on this at tab 168 and she referred to this particular book.

KÓS J:

Which page?

O'REGAN J:

Tab 168, this is cross-examination of Ms Withers is it?

MS MILLS:

That's correct. Sorry my electronic bundle has frozen, so I can't actually get you to the page of my cross-examination, 4637.

GLAZEBROOK J:

We don't have it.

O'REGAN J:

We have 4634 and 4635 in our bundle.

ELIAS CJ:

Well we can't follow this without, well unless you want to tell us what's in it and we get it later but would you like us to take a short adjournment? Will you be able to pull the material together?

MS MILLS:

Yes, provided we've actually got the electronic document and the page reference I can pull it together or I can come back to you in the morning.

ELIAS CJ:

All right well we'll take a short adjournment and perhaps you'd better look ahead in terms of the submissions you're wanting to make and identify what other documents you'll need to be referred to too.

COURT ADJOURNS: 3.18 PM

COURT RESUMES: 3.30 PM

MS MILLS:

The first question you asked was whether or not I'd cross-examined Ms Withers as to the reversal of MIP and I gave you the reference at 168, document 168 which is in the first set of documents that are put together which have got all the judgments, all the statements of claim, all the key documents.

ELIAS CJ:

Are you talking hardcopy?

MS MILLS:

Hardcopy key documents because I cross-examined Ms Withers.

ELIAS CJ:

Well that's what we've just been to and we've got one page of it. Look as I understand it, it has been explained to me, I haven't been involved with the management of this case, you had tried to give us the electronic version you were working off in the Court of Appeal. We don't have a system that can cope with that, so that's why really needed the hardcopies but we shall certainly use this to try and put a bit of pressure to get upgraded.

MS MILLS:

But the key documents were filed in hardcopy.

GLAZEBROOK J:

I'm sorry if you're talking about the consolidated bundle.

MS MILLS:

The consolidated bundle, that was put together, they were divided up –

GLAZEBROOK J:

Well we don't have the page numbers.

O'REGAN J:

The case on appeal, are you talking about the case on appeal that was filed initially?

MS MILLS:

Which were just the key documents.

O'REGAN J:

But that doesn't have a tab 168.

ELIAS CJ:

Well that's got a page of cross-examination.

GLAZEBROOK J:

But it doesn't have the full cross-examination.

MS MILLS:

No it doesn't but I was asked the question had I cross-examined Ms –

GLAZEBROOK J:

You sent us to a page and we said we didn't have it and I thought you were going to give us a copy of it while we waited for 10 minutes.

MS MILLS:

Well I'm happy to provide a copy tomorrow morning, a printed copy but it was included in the –

ELIAS CJ:

Well it's not included and we had actually mentioned that we don't have it. So we had thought you were getting it. Well that's why I asked would you be able to do it over a short adjournment because I did think it was perhaps a bit optimistic. Anyway can we make some progress or do you need to have this material in front of us?

MS MILLS:

Well it drives the next series of my argument which brings it all to fruition about the analysis between –

ELIAS CJ:

Well let's try and get to fruition. Let's take an adjournment, let's get it electronically in the clunky system that we have and let's continue until – are you happy to sit on a bit later?

ARNOLD J:

So we're talking about the Withers exercise book, that's the thing with this?

MS MILLS:

We're talking about the Withers exercise book and we're talking about the cross-examination of Ms Withers.

ARNOLD J:

Well we have got a page of that but it's not the right page.

MS MILLS:

It wasn't the right page. I was asked a question about had I –

ELIAS CJ:

Mr Galbraith, do you have some hardcopy there?

MR GALBRAITH:

No but I've got the electronic copy and it's only two questions and I'm sure my learned friend could read it to you very quickly, it's very straightforward.

ELIAS CJ:

Let's do that. Let's have you read it out and we will get the hardcopy overnight.

KÓS J:

This is page 4637 is it?

MS MILLS:

Yes. And the question I ask at line 10, “But you note on the next page about would we have met the forecast year end EBITDA if we hadn’t had the MIP reversal?” The answer is, “Yes. So that was a management incentive programme and those things are constructed to be part of the P& L and in the event they are triggered they obviously need to be self-funding so my understanding was that they were being reversed out as management failed to achieve whatever the criteria were and obviously I hadn't been involved in setting those criteria so nothing extraordinary in that. It would have been the same as any short term incentive scheme. My next question was, “However, that's how EBITDA was reached for the final year for the full financial year, wasn't it?” “Well it would be because it's not going to be paid, it should be reversed out because it hasn't been achieved. It's the same as any short term incentive scheme in any organisation.”

And so when one goes to the Joan Withers notebook and the notes of her meeting on the 22nd of June.

GLAZEBROOK J:

Is it suggested they were going to pay it?

MS MILLS:

Yes it was going to be paid, it was included in the PFI the whole way through for the whole year.

GLAZEBROOK J:

Sorry, I understand that but when they reversed it out are you saying they were still going to pay it or are you saying they were reversing it out because they weren't going to pay it which is what it sounded like Ms Withers was saying?

MS MILLS:

No they reversed out $1.5 million of MIP and then $774,000 of MIP in the financial results. I can take you to the group operating reports.

GLAZEBROOK J:

Her understanding was because they weren't going to pay it because they hadn't met the targets?

MS MILLS:

Yes.

GLAZEBROOK J:

Well is that right or wrong?

MS MILLS:

It's right in part. It's right in that they did reverse out MIP but they didn't reverse out the full amount they only reversed out 1.5 million and the notes in her own handwriting were that the reversal of MIP drove the result.

O'REGAN J:

So that's in the exercise book?

MS MILLS:

That's in the exercise book and that's at page 9371.

KÓS J:

The answer she gave you was that that was a conventional response to the incentives not – the terms of the incentives not being met. So what is your complaint in relation to this accounting?

MS MILLS:

There is no complaint about the reversal of MIP, my complaint is that there is a finding by the Court of Appeal that the results were achieved by other means and yet here is the evidence from Ms Withers that it's the reversal of MIP that drove the result.

KÓS J:

I mean it contributed to it but what's wrong with it? What's wrong with it?

O'REGAN J:

If they weren't entitled to receive it what was wrong with it?

MS MILLS:

Pardon?

O'REGAN J:

If they weren't entitled to receive MIP what's wrong with not paying it?

GLAZEBROOK J:

Wouldn't it be a cost of sale?

MS MILLS:

No it's not a cost of sale it's further back, it's an expense line.

GLAZEBROOK J:

But in a generic sense if they meet it it's effectively like a cost of sales, isn't it, so that if you take it out, if they haven't met it.

MS MILLS:

Yes.

GLAZEBROOK J:

So what's the point?

MS MILLS:

The point is that the explanation given and the –

GLAZEBROOK J:

As to higher margins, et cetera, is that right?

MS MILLS:

At paragraph 107 was that the shortfall in sales have not in any event result in the shortfall to EBITDA or net profit after tax, that's at paragraph 107. And then at paragraph 108 the Court of Appeal records that, "The investors would

have discounted this positive EBITDA figure. The appellant says the investors would have discounted this positive EBITDA figure if they'd known it was achieved by extraordinary and unsustainable cost cutting measures, the removal of bonuses for sales staff but the evidence does not bear that out. the contractual entitlement to bonuses was linked to a budget revenue figure." It was not only linked to the budget revenue figure it was also linked to the forecast revenue figure because the budget revenue figure was not met that the bonuses did not become payable but the point is that the budget still included MIP. The actual figures to 31 March still included MIP, the actual figures to that date and that's the material that's in the PFI prepared by Mr Tolan. It wasn't the failure to meet –

KÓS J:
Well the budget also included sales they didn't achieve. If they didn't achieve the sales the staff didn't get the bonuses.

MS MILLS:
Yes but they did achieve the sales, actual sales all the way through until March '04 and they were entitled to their MIP for the sales for those months.

KÓS J:
I have no idea on what basis you're making that submission.

MS MILLS:
Well just on the basis of the information that's in Mr Tolan's –

KÓS J:
Well that doesn't tell me what the self entitlement is worth. Is it whole of year, is it month by month?

MS MILLS:
It's month by month.

KÓS J:

Source?

MS MILLS:

This document that shows the month by month figure that was included in the prospective financial information and group operating –

KÓS J:

But that's an accounting treatment, it doesn't necessarily correlate to what their legal entitlement is under their employee scheme.

MS MILLS:

I'm not suggesting that it was wrong to reverse MIP I'm just saying that when you reverse MIP it creates the outcome that you're seeking to create which is an appearance that you've achieved your EBITDA figures that were included in the PFI.

GLAZEBROOK J:

But you have achieved them haven't you if you're not going to pay it?

MS MILLS:

You have achieved it but as at the 2nd of June they hadn't reversed MIP. They didn't make the decision to reverse MIP or the amount to reverse until after the 22nd of June 2004 and that's the reference that I make here in Ms Wither's notebook. So as at the date of allotment MIP was still going to be paid, EBITDA would've been lower, NPAT would've been lower but by making the decision to reverse MIP they achieved the result.

GLAZEBROOK J:

So are you saying we discount that, is that the submission?

MS MILLS:

You should discount the finding of the Court of Appeal that the result was achieved as a result of the successful strategy of changing Feltex's product

mix because all of those steps had been taken and were fully imputed into the financial information to 31 March 2004. So they were already there, so it wasn't something that occurred in the forecast, three month forecast period that improved the product mix, it didn't happen, the sales fell, they didn't achieve their results and the next stage of the argument goes to what were the margins and frankly, with all due respect to the Court of Appeal, there was no consideration of the group operating reports which were addressed in written submissions in the Court of Appeal. It's a detailed financial argument but it's credible and it's document-based and it makes sense.

GLAZEBROOK J:
So have we moved on from MIP now?

MS MILLS:
I'm happy to move on from MIP at this stage and I can get you these documents in hardcopy for you by tomorrow morning.

ELIAS CJ:
Well I think it's probably unnecessary. You're right we have access to it.

MS MILLS:
So my argument is that the achievement of EBITDA and NPAT was achieved by reversal MIP and extended credit sales and neither of those items were disclosed prior to the date of allotment. It was never disclosed that there was a practice of, a new practice that was brought into effect to increase sales, which was a relevant issue for an investor to know because it affects cash flows, it affects ability to pay dividends, it affects abilities to run your business. If you've only got low achievement of low collectabilities, that affects the outcome and Ms Withers –

GLAZEBROOK J:
Low what, sorry? If you've only got low?

MS MILLS:

If you've got extended credit and you've got a 90 day or a 120 day or a 180 day period in which people have got time to pay that affects your cash flows and that's not disclosed in the prospectus. I'm saying that that is important information that an investor was entitled to know and is one of the reasons why the untrue statement is materially untrue.

GLAZEBROOK J:

So we've gone back to the new extended credit terms, have we?

MS MILLS:

So we've got new extended credit terms and MIP drive the result.

GLAZEBROOK J:

Yes, that's right.

MS MILLS:

So that's not because of better product mix as the Court of Appeal have found. It's not because they have made more profit from better products. They achieved the result because they reversed MIP and by reversing MIP that drove the result and the effect of the extended credit sales also drove the result.

O'REGAN J:

So you're not saying there was anything wrong with reversing them?

MS MILLS:

No not at all. It was a step that could have an effect on management's performance and management's desire to continue on with the product but that's not the argument.

O'REGAN J:

That's fine, I just wanted to make sure I had that straight.

MS MILLS:

They were getting the equity incentive payments that were so large, whether they got MIP or not was irrelevant.

GLAZEBROOK J:

I think you were asked whether there was accounting evidence on this?

MS MILLS:

I need to check that, I don't have that in front of me at the moment I will come back to you on that tomorrow morning if that's –

KÓS J:

I assume Professor Newberry would have said something about this?

MS MILLS:

I'm fairly certain that she did but I just need to actually check the material.

GLAZEBROOK J:

Where did the Court of Appeal get that finding about the product mix?

MS MILLS:

That's evidence that was given by Mr Tolan.

GLAZEBROOK J:

That's what I was assuming, yes. And do you want to take us to that, not necessarily now, to say why that was wrong?

MS MILLS:

Well I'm about –

GLAZEBROOK J:

Or is the argument merely that it was MIP and extended credit that did it not margins?

MS MILLS:

No I'm about to take you to margins to show you that margins were –

GLAZEBROOK J:

So margins is different? Okay.

MS MILLS:

Margins is a cumulative part of the argument because the margins in that period were not met. The forecast margins were not met in the forecast period, that three month period. The fully imputed margins to 31 March 2004 were met but in that crucial three month forecast period they weren't met and I can take you to the group operating reports to show you how they were not met.

So first I will take you to 9155 which is the PFI created by Mr Tolan.

ELIAS CJ:

And is this in the consolidated bundle.

MS MILLS:

Consolidated bundle, and that is tab 318. Concentrating solely on the forecast period, margin after attributable overheads forecast for April '04 were 5,748,000. Forecast for May '04 6,407,000.

GLAZEBROOK J:

Sorry I have no idea where you are.

MS MILLS:

Sorry, if you look at "Margin after attributable overheads", it's about half way down the page, focussing on the white area which is the forecast period.

KÓS J:

And just to save me time will you tell me in your written submissions you are?

MS MILLS:

I'm at page 121, paragraph 121 where I've set out the statement from the Court of Appeal and then, so the arguments go from 121 through to 126. So if I can take you back to the 9155 and the margin after attributable overheads which are set out in the white columns, those are the figures that are relied upon to showed what margin was being made, including not just sale of carpets but the attributable overheads to making carpets. So those are the margin figures that we're relying on in these submissions.

Next I take you to the April group operating report which is tab 240 at page 6406. Half way down the page, "Margin after attributable overheads for the month ended April 2004." The forecast was 5,748,000, the actual was 4,724,000.

O'REGAN J:

So where do you get those figures from?

MS MILLS:

From the group management trading result New Zealand dollars at page 6406.

GLAZEBROOK J:

Go half way down, "Margin after attributable overheads."

O'REGAN J:

So the first one is the actual and the third one is the forecast?

MS MILLS:

So there's actual budget forecast and variance to last year. So you can see there that the margin wasn't achieved in April and if you go to the year to date for April, so that's all of March plus April added in and that's 6407, the forecast was 46602 and the actual margin achieved 45555. So in April margins weren't achieved.

GLAZEBROOK J:

I need to find that again?

MS MILLS:

Half way down the page, “Margin after attributable overheads.”

ELIAS CJ:

What’s the first column figure, 4724, that one?

O’REGAN J:

Have you gone over a page now?

MS MILLS:

Yes, I've gone over to the year to date figure, sorry.

GLAZEBROOK J:

So that's the difference between 45,555 and 45,602, is that?

MS MILLS:

Yes.

KÓS J:

Or 46,602.

MS MILLS:

So it's a million dollars down on year to date and for the month it's a million dollars down for the month of April.

I then want to take you to the May ’04 group operating reports and that's at tab 243.

O’REGAN J:

That year to date figure, the forecast would have been actual figures up until March, wouldn't it?

MS MILLS:

That's right.

O'REGAN J:

So the only difference would be in April?

MS MILLS:

Yes.

O'REGAN J:

So it's the same difference as on the previous page?

MS MILLS:

That's correct.

KÓS J:

Which would suggest that they'd achieved their margin for the rest of the year if there was a million difference and the million was attributed to the last month, surely.

MS MILLS:

Not if you then compare it against budget because they had to – their actual figures were included in the PFI to 31 March 2004 but their budget figures which were substantially the same as their forecast figures and the same sort of level of performance they were not achieved. So if you have a look at budget for April '04 the budget was 4953.

KÓS J:

I mean what is this really telling us that's different from what Mr Carruthers went through this morning in relation to sale, I mean, reduced sales, reduce margin.

MS MILLS:

Well it's because of the finding in the Court of Appeal decision that because EBITDA and NPAT were achieved and that margins were achieved and that

this meant that there wasn't an overly rosy picture being portrayed by the prospectus is wrong.

O'REGAN J:

But isn't reversing it just saying that your attributable overheads are reduced?

MS MILLS:

We've agreed with that proposition but what I'm saying is as at 2 June MIP had not been reversed. EBITDA was down, NPAT was down.

O'REGAN J:

But that was always only payable if you reached the target, wasn't it? So I mean the fact you hadn't reversed it yet didn't mean it was going to be payable.

MS MILLS:

But the point I'm making is that they only reversed part of MIP and they kept $774,000 of MIP in place, so they didn't reverse all of MIP.

O'REGAN J:

And the Court of Appeal said they reached their target because their margins were better, that's what you're taking issue with and you're saying that including in the margin the fact that you reversed MIP is somehow improper, but I just don't see why it is?

MS MILLS:

No, no, MIP has got nothing to do with margin.

O'REGAN J:

Well it's a cost of a sale, isn't it, if you have to pay an incentive to the seller?

MS MILLS:

MIP is to do with –

GLAZEBROOK J:

I think the argument is that's taken out later so margins are slightly different, is that right?

MS MILLS:

That's it but also MIP is reversed out of EBITDA not out of margins. So the reversal of MIP comes further down the tree.

O'REGAN J:

Well the cost of making a sale is lower because you didn't have to pay MIP, isn't it?

MS MILLS:

Yes I'd agree with it.

O'REGAN J:

That must mean the margin is higher.

GLAZEBROOK J:

Not the way they measure margin I think because it's only attributable overheads rather than the – I mean that is right it's not a proper cost of sale, it's only in a generic sense it would be a cost of sale, not an accounting term.

MS MILLS:

And the documents don't support the finding at 107 that it was their strategy of changing the product mix in that forecast period that got them to achieve their targets because it was other items, other manipulations, if I can use that phrase, of financial information to create the outcome and the appearance that the forecast and that the forecast was met.

GLAZEBROOK J:

Well what you're really saying is there were these extraordinary items that were taken out so it didn't reduce the significance of the drop in sales that Mr Carruthers had told us about this morning. So the Court of Appeal said

that it didn't matter because there were higher margins that made up for the lower volumes of sale and you say no there weren't higher margins that made up for the volumes of sale, what did make up for the volumes of sale in allowing profitability or the forecast to be met were these extraordinary write-offs which shouldn't have been taken into account or at least should've been disclosed as being –

MS MILLS:
As appearing at the date of allotment.

GLAZEBROOK J:
Is that the submission?

MS MILLS:
That's my submission and I think that actually – I'm happy to take you through the May reports to show you the same failure to achieve margins if you want to see them.

ELIAS CJ:
Well just give us the reference.

MS MILLS:
So the May reports are at 243, at page 9611 and 9612.

GLAZEBROOK J:
You mean 6911?

MS MILLS:
Sorry 6911 and 6912.

GLAZEBROOK J:
What I'm not terribly sure of is how the year to date have got better than the last time when there was a fall in margin?

MS MILLS:

Sorry I'm not understanding your question.

GLAZEBROOK J:

Well it looks as though, well on those figures the margin was 4760 against 6407.

MS MILLS:

For May?

GLAZEBROOK J:

Is that right or not?

MS MILLS:

The margin achieved for May was 4750 as against forecast 6407. So it's down by nearly –

GLAZEBROOK J:

But then when you look at the year to date.

MS MILLS:

It's down by three million.

GLAZEBROOK J:

Am I looking at the wrong figures then?

MS MILLS:

So if you're looking at margin after attributable overheads, 53 –

GLAZEBROOK J:

Oh I see yes, thank you.

KÓS J:

So was a million apart in April but it's now three million apart in May?

MS MILLS:

Yes. And then in June, the June margin which of course they did not have at the date of allotment exceeded the margin for the forecast by about $800,000 and that's at tab 244 on page 7082. So for the month of June –

GLAZEBROOK J:

Sorry can you just – it's 70, what was it again?

MS MILLS:

So the forecast – oh sorry 7082.

GLAZEBROOK J:

I don't think we've got it. Have you got it?

O'REGAN J:

Yes.

GLAZEBROOK J:

I haven't. Maybe I have. Yes I've got it.

O'REGAN J:

It's the same table but the following month.

MS MILLS:

7082, so they did achieve the margin in June but not substantially, not as much as the other two months dropped and the 7083, which is the year to date figures, the forecast was 58,590, so that's for the entire financial year and the actual was 56,743 so the margin for the year was not achieved.

KÓS J:

So the one million deficit grew to three and then it shrank to about 1.7?

MS MILLS:

Yes.

KÓS J:

But they didn't know that on the 2nd of June because those figures would only be available from July.

MS MILLS:

They didn't know about the June result but they certainly knew about the April and May results and so that's the reason why I say that the finding at 121 is incorrect.

O'REGAN J:

That's at 107 of the Court of Appeal judgment.

MS MILLS:

Judgment 107.

O'REGAN J:

And what's the finding you say we should make?

MS MILLS:

That the forecast for 2004 was an untrue statement and that it was material and that the people should have known of these factors, they should have been given the information so that they can make an informed consent and they are entitled to know what risk they are taking, they are entitled to know whether or not the promises made in respect of the shares that they were buying, the contractual obligations that they would have in respect of the shares that they were buying would be met. It's the *Arnison v Smith* decision.

O'REGAN J:

The Court of Appeal did find it was an untrue statement.

MS MILLS:

Sorry I can't hear you.

O'REGAN J:

The Court of Appeal did find it was an untrue statement.

MS MILLS:

They did but they said it wasn't material.

O'REGAN J:

So that's what you're taking issue with it.

MS MILLS:

The issue is materiality.

GLAZEBROOK J:

Well you say they said it was because the margins were improving and you say the margins in fact were getting very much worse.

MS MILLS:

Yes, and I'm saying that the rosy picture portrayed by the '04 result was to a large extent driven by the reversal of MIP and the extended credit sales and none of that was disclosed as at 2 June.

I've got another topic to do, it will probably take me probably an hour.

ELIAS CJ:

So what's the topic?

MS MILLS:

Tufters.

ELIAS CJ:

Tufters, yes. We'll take the adjournment now, thank you.

COURT ADJOURNS: 4.09 PM

COURT RESUMES ON WEDNESDAY 6 SEPTEMBER 2017 AT 09:59 AM

MS MILLS:
Your Honours, there's a bundle of documents that have been provided to you which includes some of the evidence that we've been referring to in this case and the references in the index are to tabs that are in the ECOAs, the electronic tab numbers but the hardcopies have been provided to assist you to take you through the issues.

ELIAS CJ:
Thank you.

GLAZEBROOK J:
You'll probably be pleased to know that if we run into difficulties we've now all got it up electronically on the screen.

ELIAS CJ:
But without any very good search mechanisms, so you might have to wait for us.

MS MILLS:
Well I hope that I can help you with that if necessary. There's only one issue left for me to address today and that is the issue of the Tufters which the Court of Appeal held should not be relied upon in this decision. The first point I make is this topic is not being relied on as a separate untrue statement which was the position in the High Court and the Court of Appeal before Your Honours today. It's been analysed as being as a reason why the forecast was not met in the relevant period which is that three month period between April and June of 2004 and that it was a contribution to the downward sales trend that occurred.

The next point I would like to make is that the evidence as to the Tufters developed in the course of the trial. The first time there was any significant evidence about the Tufters was when Mr Thomas was cross-examined by

Mr Forbes on various matters and the explanation was always put forward by Mr Thomas that it was the quality of the LCL and SESS Tufters that explained what was happening and rather than take you through each of those items I suggest that I just give you the references which are in the bundle which are at page 1, tab 1, the yellow tab, that's the new one.

MR WESTON:
Which we don't have.

ELIAS CJ:
You've got access presumably to the electronic material.

MR WESTON:
Yes but if she just says tab 1, we need more than that.

GLAZEBROOK J:
It starts at 3441.

ELIAS CJ:
If you could say the numbering. Will the page references do Mr Weston?

MR WESTON:
I think so. Someone more competent than I am with the computer beside me who no doubt will sort that. So we'll let you know.

GLAZEBROOK J:
That's SC3441 number, so I'm assuming you can look at that.

MS MILLS:
So it's in the tab of the ECOA at tab 147 and it's the cross-examination of Mr Thomas and the opening page reference in the ECOA is volume 9, 3357 but the pages that have been included are at page 3341, 3489, 3515, 3518, 3519, 3528 and 3562. It was this evidence that alerted the appellant to the issue of the –

ELIAS CJ:

So this was because the explanation he gave included the difficulties with the Tufter?

MS MILLS:

No he was explaining that the Tufters were going gangbusters and doing really well and doing all these things and it appeared to counsel that this was an overstatement of the position and so we started looking through the electronic bundle to see if we could find any other references that were important. And then the next step was that Mr Magill –

ELIAS CJ:

Well perhaps you can, instead of the explanation, just take us to the evidence that you're referring to.

MS MILLS:

Well at 3441 at lines 5 through to 19. In reference to cross-examination about the SIP regime Mr Thomas said, “This was the month we launched the bond issue Your Honour, the next month we were about to launch the new product on the LCL machine. There was some very big things happening in Feltex at this time.” I do know, Your Honour, and I had this general recollection that it was a SIP area that we were concentrating on in Feltex at this time because we knew we had some capital expenditure coming down the track with the LCL machines and the SESS machines that are important to us so I can absolutely remember this paragraph, sorry, I just can't remember even the worked example. I can't recall now to that extent, Your Honour, but this outcome was important to us.”

ELIAS CJ:

What's he referring to though?

MS MILLS:

He’s referring to the SIP grants, SIP grants are the grants –

ELIAS CJ:

No, but he's referring to a document, it's quite difficult to follow the cross-examination without having the document. What's the document he's referring to?

GLAZEBROOK J:

I don't think you're relying on the document, are you, you're relying on his explanation.

MS MILLS:

No, I'm not relying on the document at all, I'm relying on the explanation that he's giving.

GLAZEBROOK J:

For not remembering the document, is that?

MS MILLS:

Yes.

ELIAS CJ:

All right.

KÓS J:

Well we've got a reference to tufters here but no gangbusters yet so I presume you're getting us to gangbusters, are you?

MS MILLS:

I'm taking you there at 3489. I'm going to say, Your Honour, that that paragraph is absolutely related to the prospectus' at line 9. I think we actually had, "Well we'd hoped that for market share increases at the board level were higher than what we disclosed in" –

GLAZEBROOK J:

Sorry, the line number.

ELIAS CJ:

It's about 11, line 11.

GLAZEBROOK J:

Line 11, thank you.

MS MILLS:

"I think the prospectus was more conservative and because of the introduction of the LCLs more than one machine there were several machines and the SESS machines, I think we looked for a bit more market share, growth which was not coming our way," so that was the explanation there that they were wanting further machines to increase their market share.

3515, at about line 7, in answer to a question about a strategic review. "Yes, it had not gone to the depth that I was going to undertake it. The reason, Your Honour, we got into the LCL and the SESS machines was because of an international review. We were looking at trending overseas, we looked at fashion trends, we used the Shaw Technology agreement, we saw the opportunity and we took it, so this is the sort of thing that had gone on. I was just a new chief executive officer and I wanted to start at the basics which I think a new chief executive officer would do." That of course is after Mr Magill has resigned and Mr Thomas is appointed. So once again it's yet another reference to the SESS machines as being important to their development of their products.

O'REGAN J:

So when did Mr Magill resign and Mr Thomas take over?

MS MILLS:

I'm sorry, I will actually have to –

O'REGAN J:

Well just in relation to the float?

MS MILLS:
Mr Magill resigned in 2005.

O'REGAN J:
So how long after the float roughly?

MS MILLS:
Twelve months and Mr Thomas –

O'REGAN J:
So this is talking about the machines, this is talking about a period a long time after the float then, is it?

MS MILLS:
This is about the projections?

O'REGAN J:
Is this still in the period of the projections?

MS MILLS:
The projection goes to 30 June 2005.

O'REGAN J:
So it's not in the forecast for the year ending 2004?

MS MILLS:
That's not in the forecast figure, no.

So 518 is put in for the reference to how these questions about the SESS Tufter comes about. 519 is the relevant answer at paragraph 2. "These were the things the boards were going to look at which is the arms that were going to be used. It's a question of whether they're top of the list or whether the top of the list, Your Honour, is getting the new LCL product and SESS product into the market. It was, you know, I'm not going to say that we did not look at the thing, at these things we did. Were they the top of the list

of the board's priorities at the time earlier? No. They came to the top of the list post about the March period of 2005."

Then the next reference to the LCL and SESS Tufters is at 3528 and it's in line 19 and Mr Forbes asks, "And the need to better align your manufacturing to the higher value of segments of the residential market was not that something had already been considered? Yes we had Your Honour. We had the LCLs and the SESS machines were targeted at the higher value products, particularly residential, so we had considered it in March and were continuing to consider it."

O'REGAN J:
When he refers to "Your Honour", he's not answering a question from the Judge, he's answering a question from counsel is he?

MS MILLS:
He's answering a question from counsel but Mr Thomas addressed the Judge each time and then he refers at page 3562 that they were the sole suppliers in the general marketplace and that's at line 7. So those were the matters that alerted the appellant to the issues that were being addressed in terms of the importance of the LCL and SESS Tufters and that's the reason why we started looking at these issues as opposed to focussing on just the revenue issue.

KÓS J:
In your written submissions you focus on the SESS Tufters.

MS MILLS:
Yes because the LCL Tufter was successful. The SESS Tufter had significant problems and that's addressed first in Mr Magill's evidence which is in my submissions at paragraph 68 of my submissions. Under cross-examination Mr Magill stated that there were problems with the SESS Tufter being the principal reason that he assigned to the shortfall of sales in the three month

forecast period in FY04 and that document is at tab 160 in the common bundle.

O'REGAN J:
Which is tab 3 of this.

MS MILLS:
No in the consolidated bundle. I have actually put it in at tab 3 as well, Your Honour, you're correct. Just for ease of reference I've put in all the references Mr Magill has made to the SESS Tufters. So if you do go to the supplementary bundle I've provided these are the extracts that relate to the SESS Tufter. So the first extract I refer Your Honours to is at page 4225. The question was, "Right was there any discussion that you recall of the implications of the shortfall in the financial year 2004 as to the projection for sales revenue, operating revenue for the following year? I can't remember Mr Forbes but I think Des Tolan might've mentioned somewhere in his evidence that that shortfall was primarily because of two factors Your Honour, one was the new SESS machine where technical problems with the first machine, basically all the parts, the individual serve" that should be "servo motors, had to be replaced by the manufacturer and that slowed down product moving to the market and it was of the order of about $3 million, so three million of that 7.5 to nine and that's the anticipated shortfall for sales, evolved due to that technical difficulty with the machine and if my memory serves me correct Your Honour, the other difference were the translational effects in converting Australian sales into New Zealand dollars."

The next reference is at 4269 in answer to a question from Mr Forbes about sales results. "Given the sales results up to the date of the closing of the prospectus did you, Mr Magill, realise Feltex would not meet its financial year '04 forecast and that should have caused them, and I put it to you Mr Magill, yourself as well and as well the due diligence committee to reconsider the achievability of the projected financial '05 results." "No Sir, completely incorrect." So he says no it makes no difference for the projections. "If you look at 2004 we're short between 7.5 and nine million which, as I explained

earlier in the evidence, was due to a mechanical problem with the new SESS machine which contributed about three million of that shortfall. In terms of the other roughly five million the translational effect between the New Zealand and Australian dollar, so that statement is incorrect, Mr Forbes."

The next reference is at page 4278 at line 9, at line 10 where Mr Magill volunteers. "There were two others not covered and the reason for the order of the second machine was, as I've just indicated, was because we had mechanical problems with that machine and I wanted to bring forward a second machine as quickly as possible because we would lose market opportunity on the first SESS which was giving us mechanical problems."

So in my submission, Mr Magill's evidence is quite clear that this machine was giving them serious mechanical problems and that it was attributed to the shortfall in the revenue forecast period of April through to June 2004. So he's attributing $3 million to the problems with the SESS machine. So the next issue is was there any other cross-examination –

ELIAS CJ:
The 1 per cent expected lift in sales attributed – was it attributed to these machines, is that right?

MS MILLS:
No the shortfall was attributed to the machines and the –

ELIAS CJ:
No I'm just thinking about –

MS MILLS:
The uplift in the sales?

ELIAS CJ:
Yes.

MS MILLS:

As dealt with in the 8 April presentation which is where I was going to take you to next shows that there was to be a contribution from the SESS machine which would manufacture woollen carpet and there would be a $1 million, I think it's about 800 and –

ELIAS CJ:

I just thought that I had read reference to a 1 per cent -

MS MILLS:

That's in relation to the market share increase between 2004 and 2005.

ELIAS CJ:

Yes.

MS MILLS:

And so these machines were certainly to contribute to a market share increase.

ELIAS CJ:

Yes, that wasn't specifically averted to in the prospectus though, was it, there was reference to these machines but there wasn't any indication of what they were expected to contribute, is that right?

MS MILLS:

No, that is correct.

ELIAS CJ:

Thank you. Was that just an internal assessment that it would increase market share by 1 per cent?

MS MILLS:

I don't believe that the allegation was that the tufters would increase market share by 1 per cent.

ELIAS CJ:

I see.

MS MILLS:

I believe that the evidence was that they would contribute to an increase in market share of 1 per cent.

ELIAS CJ:

I see, all right.

MS MILLS:

So there were other –

ELIAS CJ:

There were other factors, yes I see.

MS MILLS:

There were other factors, but of course the statement at page 51 of the prospectus deals with the strategies to increase sales revenue and that's what we say underpins the untrue statement in the forecast figures.

KÓS J:

Is it accepted the machine was repaired?

MS MILLS:

The machine was repaired yes and it made commercial carpet, what's called solution dyed nylon carpet as opposed to woollen carpet.

KÓS J:

Is it accepted it also, as the respondent say in their submissions, referring to evidence also is capable and did perform in wool?

MS MILLS:

Those are the submissions however there are documents which were put to witness which said that the Board did not know that the machine could not make wool. So it becomes a question of –

KÓS J:

That's not my question, my question was did they make wool?

MS MILLS:

Well there was no evidence that they did, there was no evidence produced that they did.

KÓS J:

That's not my recollection of what the respondents are saying.

MS MILLS:

Well the respondents are saying it was their recollection that they made woollen carpet but when you put to them the statement that there is no ability for woollen carpet to be produced, there was no response apart from an oral statement that it was their recollection they could make woollen carpet but of course would only be relevant to the projection period and we're focussing on the forecast period when it couldn't make woollen carpet and that's admitted by – well any carpet at all at that stage and that's admitted by Mr Magill in his evidence. We're focusing now on the forecast period as opposed to the projection period in terms of the SESS Tufter.

KÓS J:

Where I was getting to is what the respondents are supposed to do with this adverse fact. Are you saying they should have disclosed the technical problem or is it simply a supporting detail to the forecast being untrue?

MS MILLS:

Yes but it's a risk factor that should have been disclosed in terms of the Securities Regulations.

GLAZEBROOK J:

What was the risk factor? That it had broken down at that time?

MS MILLS:

That it was broken down and not performing at that time and it contributed to the shortfall in the sales and it had to be repaired and it was, as Mr Thomas' evidence that I took you through demonstrates, they were focusing on the performance from these LCL and SESS Tufters being important to meet their margin and to meet their revenue projections.

KÓS J:

So you're arguing it was material to the trading prospects and should have been the subject of some form of continuing disclosure?

MS MILLS:

Yes.

GLAZEBROOK J:

Although it would've been portrayed, and quite rightly, as a temporary problem. It's not an ongoing problem, at least as far as they knew at the time is it or is this the point of the wool, other issue that you've averted to?

MS MILLS:

Well I'd like to take you to Mr Horrocks' evidence if I could.

GLAZEBROOK J:

Well perhaps just tell me what the submission is? Because I just said, I mean a machine's broken down, yes it might actually have an effect but it's not an ongoing effect is it? So trading prospects, it's a short term effect on trading prospects, not a long term.

MS MILLS:

That's correct, however at the time the machine was broken down it was unable to pull the wool through the servo which is what was causing the

problem and if that problem could not be solved it would affect the projections going forward. So this was a new machine was being used to make a particular type of carpet that's always been important to the increase in sales they were forecasting and projecting. So if this machine was unable to pull the wool through the servo until it was corrected and there was no guarantee that it ever would pull the wool through the machine, pull the wool through the servo sorry, that that is a specific factor that should've been disclosed that there was – they were looking forward to improving their sales and relying on both the LCL and the SESS Tufters to contribute to those sales increases without the ability to, for this machine to operate properly that, of itself, must be a factor that should have been disclosed, in my submission.

O'REGAN J:

So are you saying the effect of the machines not working was that they weren't able to produce enough carpet to meet their sales targets, because I mean I thought the problem was they just couldn't sell the carpet, not that they couldn't produce it.

MS MILLS:

They couldn't produce it at all according to Mr Magill in that forecast period and it couldn't make woollen carpet at all in the forecast period and we say also the projection period. So because of the document produced –

O'REGAN J:

Does that mean Feltex as an organisation couldn't make woollen carpet?

MS MILLS:

Feltex could make woollen carpet in New Zealand and made very beautiful woollen carpet in New Zealand.

O'REGAN J:

So what was the problem with this machine not being able to do it?

MS MILLS:

Because it was suppose – in the 8 April presentation it's supposed to be one of the contributing factors to the increases in sales, this is a new machine being brought on, brought in and anticipated to be starting to make carpet in the forecast and projection period to increase sales, so that was why it was important.

If I can take you to the –

KÓS J:

Is the only evidence of its direct impact on reduced sales the comments by Mr Magill?

MS MILLS:

Yes.

KÓS J:

Is the only direct evidence?

MS MILLS:

And also the direct evidence in the due diligence committee meeting on 2 June as to an explanation as to why sales revenue wasn't met.

KÓS J:

Right, can you take us to that?

MS MILLS:

Yes, yes I can. So that's at tab 369.

O'REGAN J:

Is it in this new material?

MS MILLS:

No I'm sorry it's not, Your Honours, it's in the combined bundle.

GLAZEBROOK J:

It will be in the consolidated bundle, what tab?

O'REGAN J:

It's tab 360.

GLAZEBROOK J:

360.

MS MILLS:

So at page 9812 there is no specific reference to the SESS Tufter anywhere in this particular document, however, Mr Magill in the second paragraph under 3.1 advises that the company might not meet its sales forecast for this period due to the following reasons, the newly introduced growth rebate scheme for retailers resulted in good sales for March however the market slowed in April and May and retailers have taken longer than expected to move the stock they had purchased in March. In addition the scheduled April plant closures for maintenance resulted in the company not being able to deliver certain sales by the required delivery dates, and unforeseen production issues which in turn impacted on delivery time including issues with solution dyed nylon which led to approximately a $3 million shortfall for April and May and that is the reference to the SESS Tufter and solution dyed nylon issue has now been resolved. The amount of the shortfall in sales revenue compared to the forecast would be in the order of 7.5 to $9 million, less than 3 per cent of the annual sales. So that's the reference to the due diligence committee meeting on the 2nd of June.

KÓS J:

So he doesn't mentioned there the translational problem with the foreign currency, does he?

MS MILLS:

No he does not and if one actually goes to look at the translational effect which I haven't addressed in my submissions, that actually did not have an

impact in FY04 because in actual fact when one looks at the annual report there is actually an increase in the dollar revenue as a result of the translational effect, but that is not a matter that we're addressing today.

ARNOLD J:
There's a reference at the bottom of this page to the LCL machine.

MS MILLS:
Yes.

ARNOLD J:
Is that a form of tufter?

MS MILLS:
It is a tufter. There were two new sorts of tufters, the LCL and the SESS tufter, so that is a different tufter and it was doing well, it was performing well and you can see that in the CAPEX report which is the document I was about to take you to after I was going to take you to the 8 April presentation to show you the strategies that were being put in place.

GLAZEBROOK J:
Doesn't this make it look much more like a temporary problem especially when they are looking at a second LCL machine which doesn't come into the projections and the issue about making it up in June after difficult months.

MS MILLS:
Yes, but that's when you go to the CAPEX review it shows that the SESS tufter never makes –

GLAZEBROOK J:
I suppose it depends really, I mean I can understand that if those two months had an adverse effect that wasn't one off because of difficulties there is an issue but if it's one off because a particular difficulty meant to be made up in

June which is what this suggests, is it actually such an ongoing problem as you would submit it to be?

MS MILLS:
Well until such time as the machine can make woollen carpet –

GLAZEBROOK J:
Well does it matter if they are getting a second LCL machine or is it a different?

MS MILLS:
No they actually buy a second SESS machine as well in July.

GLAZEBROOK J:
So they had one dud machine and they decided to – sorry, I meant that in the sense of one can buy a machine which is a dud because that particular machine is a dud rather than a generic SESS machines being duds and presumably because they bought a second one they thought they'd just got a bad SESS machine rather than that SESS machines were bad generally.

MS MILLS:
If I could take you to Mr Horrocks' evidence because he gave significant evidence about the SESS machine because he was the person who actually asked for the CAPEX review because the SESS machine wasn't producing at the rate that they'd anticipated.

ELIAS CJ:
Reference?

MS MILLS:
The reference is in tab 171 and if you go to page 4718.

GLAZEBROOK J:
4718 did you say?

MS MILLS:

Yes.

GLAZEBROOK J:

I don't think we have that?

MS MILLS:

Sorry, that's the first page.

GLAZEBROOK J:

First page, all right.

MS MILLS:

And his evidence is all in the combined bundle. So the evidence is from 4748 to 460. At 4748, which is at line 6 I take Mr Horrocks to the CAPEX post implementation review report for the LCL tufter and the SESS tufter.

GLAZEBROOK J:

You probably should tell us where those are or else we're not going to understand this, are we, and hopefully it's not every second page.

MS MILLS:

It is every second page I'm afraid.

ELIAS CJ:

Can you just give me the page reference again.

O'REGAN J:

4748.

GLAZEBROOK J:

Or if you don't think we need to look at it then that's fine.

MS MILLS:

I'm happy to take you to the CAPEX.

GLAZEBROOK J:
Is it in the consolidated bundle?

MS MILLS:
It's at tab 341

GLAZEBROOK J:
It's just that it's sometimes difficult to understand what people are talking about if you don't know what document they're looking at.

O'REGAN J:
What was Mr Horrocks' role in this?

MS MILLS:
He was in charge of the audit and risk management committee, he was a director, and he took a specific interest in the new tufters.

O'REGAN J:
So which volume was the report in, did you say?

MS MILLS:
It's tab 341. This was part of the consolidated bundle in the High Court and it only included unfortunately every second page, there is no explanation for how that occurred. It's at page 9559 and I note in my submissions that the appellant was not responsible for the preparation of the common bundle.

So the first part of the CAPEX review document take you through the LCL tufters which shows that it was a highly successful machine and then the second part of the CAPEX review which is at page SC9564 addresses the CAPEX review for the SESS tufter. So the project proposal was to install the SESS tufter at Braybrook which is in Australia and that technological advances had led to the commercial carpet experiencing increasing popularity and the development of textured product and that Godfrey Hirst established

themselves as market leaders in this area and the benefits of the SESS tufter were set out in paragraph 1.3.

Paragraph 1.4 deals with the project financials. And then at paragraph 3 it was determined that in order to remain competitive Feltex needed to obtain scroll design technology which is the SESS tufter for commercial grade carpet. In selecting the SESS tufter not only can Feltex compete with scroll designs but Feltex can also become effective market leaders utilising the latest technology. Of course commercial grade carpet is nylon carpet or SDN carpet, it's not woollen carpet. The project was approved in 2002 and physically completed in 2003 when it was handed over for production and it was capitalised on 29 June 2003. There are five standard ranges being run on the machine, wool and three synthetic. Commissioning problems, and then it sets out what the commissioning problems were.

KÓS J:
Yes, we'd have liked to see page 4.

MS MILLS:
Yes I would have liked to have seen it too, Your Honour. I'm sorry, it's just not there but the key learnings and recommendations which are in paragraph 4.

Production rates on the original capital submission were a best estimate as the technology being used was untested for production of carpet using wool. The more recent SESS capitals submission for the purchase of the second machine has taken into account this and production rates are less ambitious. And then it sets out, with new technology it is essential to complete a post-implementation review prior to any subsequent purchases. Had this review taken place prior to the capital approval of the second SESS tufter a different outcome may have resulted.

If you go to the next page please and just keep going down. So at 9568 it shows that the revenue generated from the SESS tufter in the financial year 2004 was $868,602 and it was expected to make – and it made $3.9 million

for 2005. So in order to evaluate the effect on the problems with the machine you now have to go to the presentation of the 8th of April 2004 which is at tab 307.

GLAZEBROOK J:
Sorry I didn't catch that?

MS MILLS:
307.

ELIAS CJ:
What volume?

GLAZEBROOK J:
307.

ELIAS CJ:
What volume?

MS MILLS:
I've got it in 3. This is the presentation that was made to the directors and the joint lead managers on the 8th of April 2004. It sets out the –

O'REGAN J:
This was made to who? To the directors or to the due diligence committee?

MS MILLS:
The directors were present.

O'REGAN J:
So it was to the committee and the directors?

MS MILLS:
Yes. This is Mr Tolan's presentation.

ELIAS CJ:

Can you tell me again where it is?

MS MILLS:

307, tab 307. And if you go to page 8931 that's the sales and margin by product group, then 8932 it's quite hard to read but if you look closely the forecast for 2004 was 128,492.

O'REGAN J:

Sorry, when you move away from the microphone we can't hear you.

MS MILLS:

Sorry.

KÓS J:

So you're in the top right-hand box?

MS MILLS:

Top right-hand sales value. So the combination of the existing tufters that were making product was a mixture of the existing ones were making 128,492 and a million dollars and the SESS tufter was supposed to contribute in 2004 1395.

O'REGAN J:

1365.

MS MILLS:

1365 to the sales forecast.

O'REGAN J:

Well that 1365 is the total figure isn't it?

MS MILLS:

No 1365 is, if you look, there's excluding SESS Tufter and then the SESS Tufter, so the little white line in the middle of the box shows what the other

tufters were making, were forecast to make but the SESS Tufter was supposed to make $1.365 million.

KÓS J:
Did we just see a moment ago that it made 800,000?

MS MILLS:
Made 800,000.

KÓS J:
So the difference is 500,000.

MS MILLS:
No that's not quite what it is. Could you scroll down please. This is about wool, this is only in relation to wool.

KÓS J:
I see.

MS MILLS:
And it's not making wool in this period, it's making SDN, so it was an inability to make woollen carpet in that period which contributed to the shortfall in sales.

O'REGAN J:
So the submission, it was meant to make 1.3 million and it didn't make anything in terms of wool.

MS MILLS:
In terms of wool and it made 800 odd thousand in terms of SDN.

O'REGAN J:
So what was it budgeted to do in respect of the other carpet or forecast to do?

MS MILLS:

In terms of the other carpet, in terms of SDN, the next page will address that.

O'REGAN J:

So is there a shortfall of 1.3 million or once it stopped making wool did it start making some other product that generated revenue or did it just not make anything?

MS MILLS:

Well according to Mr Magill that was actually even greater than the CAPEX review shows, it was three million shortfall from the SESS Tufter.

KÓS J:

Well if we apply your logic, if we look at the next page, top right-hand box, was supposed to make $800,000 worth of SDN and it's made 1.167. So it looks like they've –

MS MILLS:

No, no was supposed to make 1.167 and it made 800.

KÓS J:

Oh that's forecast, right.

MS MILLS:

Other way round Your Honour.

KÓS J:

Yes thank you.

MS MILLS:

So it was behind on the SDN as well.

O'REGAN J:

So where is all this taking us to? What are you asking us to deduce from all this?

MS MILLS:

What I'm asking you to deduce from all this is the point that I made at the beginning of my submission which is that this was a significant problem that should have been disclosed that the machine was unable to make woollen carpet at all and had other long lead time set up issues that meant that it was never as profitable as it was supposed to be.

O'REGAN J:

But a lot of that emerged after the prospectus, after the offer was closed. I mean the evidence you took us to of Mr Magill was talking about 2005.

MS MILLS:

What Mr Magill was talking about in the due diligence committee meeting and in the evidence that he gave was that the shortfall was caused by the failure, caused to the value of $3 million because of the failure of the machine to make carpet in that period, in that three month period, not just over the full annualised year but within that three month period it failed to make $3 million worth of carpet.

O'REGAN J:

But that's only an issue if it's an ongoing problem isn't it? I mean that was the point Justice Glazebrook was making to you before. If it's a one-off problem and then gets fixed, it's not material is it?

MS MILLS:

But it hadn't been fixed by the time of the bring down due diligence meeting.

KÓS J:

I mean these are technical evaluations which require technical evaluative evidence. I mean how do we draw that inference?

MS MILLS:

Simply because of the evidence given by Mr Magill, that was his explanation for the shortfall.

GLAZEBROOK J:

Well obviously when a machine breaks down and you can't produce, that's going to have an effect but was there anything, you said you were going to take us to something that showed that they knew it was as ongoing problem because at the moment it looks like they didn't know it was an ongoing problem. I must say that when you took us to the CAPEX review it appears they had already decided to buy the other machine even without perhaps doing a full review.

MS MILLS:

Yes.

GLAZEBROOK J:

But they seem to have decided that at a time when they were having problems so that would suggest that they didn't see them as terminal problems at that stage or at least the techo people didn't.

MS MILLS:

That's correct because the machine could always make SDN.

ARNOLD J:

Sorry, could always make what?

MS MILLS:

Solution dyed nylon carpet so –

GLAZEBROOK J:

Well we haven't seen anything about the wool issue.

MS MILLS:

I was just going to take you to it.

GLAZEBROOK J:

You are going to take us to it now?

MS MILLS:

Yes, and that is, if I can take you to the supplementary bundle at tab 002.

O'REGAN J:

The supplementary bundle is the one you've just given us this morning?

GLAZEBROOK J:

It's the little baby one here.

MS MILLS:

The little baby one.

GLAZEBROOK J:

What tab?

MS MILLS:

Tab 002.

GLAZEBROOK J:

We don't have a 002, we've got a little 2, is that what you mean?

MS MILLS:

Sorry. And if you go to page 14556.

O'REGAN J:

We haven't got SC pages in this, what are the pages you're going on?

ELIAS CJ:

It's the second to last page, isn't it? Sorry, what is this?

MS MILLS:

This is a meeting of the audit and risk management committee held in Melbourne. Present at this meeting was Mr Hunter, Mr Hagan, Mr Thomas, Mr Tolan and Mr Saunders.

GLAZEBROOK J:

In 2006?

MS MILLS:

In 2006. This is after they've received the CAPEX report.

O'REGAN J:

Sorry, after they'd received what?

MS MILLS:

The CAPEX report. The Board, and we're under the little heading, "CAPEX reviews updated SESS tufters." The Board was not aware that these tufters were not able to service wool.

O'REGAN J:

Whereabouts on the page are you at the moment?

MS MILLS:

Third box down –

ELIAS CJ:

On the right.

MS MILLS:

Third box up from the bottom.

GLAZEBROOK J:

General and next meeting and then the one up from that and it's the under SESS tufter.

O'REGAN J:

CAPEX reviews update, is that the box?

MS MILLS:

Yes, that's correct. And so that's the evidence that we relied upon to establish that there was this problem with woollen carpet and they were unable to service wool and that that was an ongoing problem that was never resolved.

KÓS J:

Well does it say that?

ELIAS CJ:

2006 you're saying?

MS MILLS:

2006, yes.

KÓS J:

Well,I mean, when?

MS MILLS:

I'm sorry Your Honour, I don't understand your question?

KÓS J:

Is that a description of the SESS tufter for all time or is it a description of it at a past period or is it a description of it for the period up to this point? I mean it's inconclusive. We're not able to service wool but?

MS MILLS:

And it makes SDN, but it makes solution dyed nylon so my point is that in the 8 April presentation the focus was on increasing and upselling and upgrading the market mix so that you were actually making more premium and middle market, middle woollen carpet and that that was one of the reasons why sales were to increase, they were driven by the SESS tufter that was going to make this fabulous woollen carpet and it didn't.

O'REGAN J:

But we need to know what the directors knew at the time the offer closed, not what they knew 18 months later.

ELIAS CJ:

We interrupted you when you were taking us to some evidence, did that bear on this?

MS MILLS:

That's Mr Horrocks' evidence?

ELIAS CJ:

Yes, were you taking us to that? Does it bear on it?

GLAZEBROOK J:

What was the date of the CAPEX review again because that's after this period as well?

MS MILLS:

November '05

GLAZEBROOK J:

I mean he's complaining, as I understood him, that they hadn't brought it properly, I mean which might be a management issue. So he's almost saying we didn't know about this because we didn't have a proper review and management weren't informing the Board properly of these problems.

MS MILLS:

Yes that is a fair estimation of what's been recorded in the documents.

GLAZEBROOK J:

So that would suggest at the time we are talking about that they didn't know.

MS MILLS:

No they didn't know. They didn't know as at –

GLAZEBROOK J:

And any of the explanations they were given at the time had absolutely nothing to do with tufters did it? It was, you know, there's been holidays, there's been the March rebate, all of those other explanations that were given, they were given sorry.

MS MILLS:

Mr Magill's record in the due diligence committee was this was a problem which caused the shortfall and then he gives oral evidence to support that.

GLAZEBROOK J:

So that's the report that you were just taking us to is it?

MS MILLS:

That's the due diligence report of 2 June.

ELIAS CJ:

Before it was all closed off?

MS MILLS:

The due diligence meeting on 2 June.

GLAZEBROOK J:

And you're saying the Board members were at that?

MS MILLS:

No and there was a Board meeting after that.

GLAZEBROOK J:

So which was the presentation they were – I thought you said the Board was at that presentation.

MS MILLS:

The presentation on 8 April.

GLAZEBROOK J:
All right not the 2 June.

MS MILLS:
If I can take you to Ms Wither's exercise notebook which is in your new bundle at tab 5. The page reference 9369. These are her notes.

ELIAS CJ:
Of what?

MS MILLS:
These are her notes of the meeting that she attended as a director on 2 June.

O'REGAN J:
On 3 June did you say?

MS MILLS:
2 June. So the director's meeting was after the due diligence meeting and the notes show that Sam, referring to Sam Magill, John, referring to John Kokic, reported how the company was travelling, forecast and projections. Sam went through the movements, forecast will be met, sales shortfall April and May and then she sets out the various issues that she was informed about which was causing the shortfall in sales.

ELIAS CJ:
What are you directing our attention to here?

MS MILLS:
I'm just directing your attention to the fact that there was a due diligence committee meeting followed by a directors meeting and the decision was made to allot at the directors meeting on the same day.

ELIAS CJ:
And what in this note are you particularly –

MS MILLS:

Oh just that she was informed about the sales shortfall. So she knew there was a sales shortfall.

GLAZEBROOK J:

Well we know they knew.

MS MILLS:

Yes. My point is to actually get the timing correct because there was no significant gap between the due diligence committee meeting and the directors meeting. It all occurred on one day and the allotment took place on that day.

KÓS J:

There's a reference in the box to the second LCL Tufter.

MS MILLS:

Yes, that's correct. So I'm just taking you to this particular page because it shows the continuity between the due diligence committee meeting and the directors' meeting.

GLAZEBROOK J:

Is there anything that shows the SESS tufter was brought up at the directors' meeting?

MS MILLS:

No.

O'REGAN J:

Magill was a director obviously.

GLAZEBROOK J:

There were continuities between the two, sorry, I meant the other directors.

MS MILLS:

Well of course Mr Magill was a director.

GLAZEBROOK J:

Yes.

MS MILLS:

And he knew as did Mr Tolan.

GLAZEBROOK J:

Well obviously anybody who was at the due diligence committee meeting knew?

MS MILLS:

Yes, and Mr Magill knew and he was a director and he was at both because he was there to give evidence at the due diligence committee interview.

So I was going to then take you to the substantial evidence in respect of Mr Horrocks because it was he who'd asked for the CAPEX review but by the time that review was completed he had resigned and left the Board. So I will take you to the tab for Mr Horrocks, tab 170. So at page 4748 I direct Mr Horrocks to the CAPEX review document which is the one that has only every second page.

O'REGAN J:

It's tab 171, isn't it? Tab 171 not 720.

MS MILLS:

I'm sorry, tab 170 is in the ECOA and I haven't included it in this new bundle which is actually evidence-in-chief that he gave to Mr Galbraith.

ELIAS CJ:

But where do you want us to go?

GLAZEBROOK J:

4716, is that evidence-in-chief of Mr Horrocks?

MS MILLS:

Yes it is.

GLAZEBROOK J:

Because he's talking about the procurement process?

MS MILLS:

At 4716?

GLAZEBROOK J:

Yes.

MS MILLS:

At line 14 –

ELIAS CJ:

Sorry, what page are you on now?

MS MILLS:

4716 which is –

ELIAS CJ:

All right.

GLAZEBROOK J:

Well what he says there is there wasn't an ongoing problem. Sorry, I'm reading 4716 which I don't think you were taking us to but –

MS MILLS:

No but that is –

GLAZEBROOK J:

There's where he says there wasn't an ongoing problem?

MS MILLS:

That's correct, but he does explain – "Which does explain when the tufter arrived the machine was having difficulty as far as I recall and Mr Magill would be able to assist the Court further if it was necessary on this or Mr Tootell but when it arrived there was some difficulties in terms of the way that the servo motors could pull the wool mix through the machine was then dedicated – so the machine was then dedicated to manmade fibre until that issue was resolved with the manufacturer. At the time I left, as far as I can recall, I believe the manufacturer agreed to change all the servos," and of course he leaves in April 2005 so it's up until April 2005 they still haven't got the servos all changed.

KÓS J:

But he says on the next page he understood the machine actually did produce wool mix carpet subsequent.

MS MILLS:

Yes, but that's after April 2005 not in the forecast and not in the bulk of the projection period. Sorry, his evidence-in-chief is that the machine didn't make woollen carpet until after he left which was in April 2005, and so I think that clears up –

O'REGAN J:

What does this tell us about, what should have been disclosed in the prospectus thing?

MS MILLS:

Well we have Mr Magill saying that the loss –

O'REGAN J:

No, what does Mr Horrocks' evidence tell us? You've taken us to this evidence, what are you asking us to take from it?

MS MILLS:

But what Mr Horrocks' evidence tells us that throughout the forecast and projection period this machine was not making woollen carpet.

O'REGAN J:

But that's a looking back thing, isn't it, that's telling us what happened after the prospectus. What I'm asking you is what does it tell us about what the director should have done before the offer was closed?

MS MILLS:

What Mr Magill should have done?

O'REGAN J:

No, what should – it's pointless telling us about things that happened 18 months later, what we want to know is what had to happen at the time the prospectus was registered and then at the time the allotments were made?

MS MILLS:

Well at the time the allotments were made Mr Magill is a director of the company.

O'REGAN J:

I know that but I'm asking you why Mr Horrocks' evidence of what happened 18 months later has any relevance to that?

MS MILLS:

Because it establishes that the submission that I've made that the SESS tufter did not make woollen carpet is correct.

ELIAS CJ:

Well that might be so as a matter of history, that's what happened, but you're being asked about what the directors should have done at the earlier period.

MS MILLS:

My learned friend has just assisted me with the point that at the time of allotment Mr Horrocks knew that this machine did not make woollen carpet.

KÓS J:

So it doesn't quite answer the question. You answered the question earlier, I think, when I asked you what should have been done and you said they should have disclosed this problem before allotment.

MS MILLS:

Yes.

KÓS J:

That's what you're driving at?

MS MILLS:

What I'm driving at is that it supports the submission that we make that the sales revenue shortfall was contributed to by this particular failure of this particular machine and that was a significant –

KÓS J:

Well that's a detail. What is important is there was a reduction in sales and then the next question that's important is why and the next question, once you've worked out why the sales are reduced is whether it's a blip or a permanent decline. Now if it's a technical problem it may be a blip. If my car breaks down in the morning I ring in and say I may be late, I don't say you won't be seeing me again.

MS MILLS:

That's correct, but when you have a machine of the size and significance of this SESS machine and it is not fixed as at the date of allotment and does not get fixed until after Mr Horrocks leaves you've got evidence of a failure of that machine to perform, it was –

O'REGAN J:

Yes I know but what we want to know is did the directors know in June 2004 that the machine wouldn't be able to be fixed until April 2005, unless they knew that it doesn't matter whether it was or not, all we want to know is what they knew at the time?

MS MILLS:

The person who knew was Mr Magill.

O'REGAN J:

I know but you're taking us to the evidence of Mr Horrocks and I'm asking you what's the point of it?

MS MILLS:

The point of it is to establish that not only did Mr Magill know but Mr Horrocks knew as well.

ELIAS CJ:

Well why don't you take us to the additional bits in the evidence. You wanted to take us to the cross-examination and let's complete that.

MS MILLS:

So at 4748 I give a copy of the CAPEX post-implementation review document to Mr Horrocks who says that he has not read it, and I ask him to take the time to read it. And then at page 4749 at line 15 Mr Horrocks is talking about the SIP grants and the tufters were part of that programme, that's at line 16. "That was the first tufter, I think that refers to the first tufter, but I'm cold on this. I'm not sure I can really make any useful comment." And then I refer him

to the commissioning problems in the CAPEX report that, “They have been run at reduced speed and therefore output had been low and there’s some specific reasons for the reduced production, do you see that there under commission problems, and this relates to the SESS tufter that was installed in June 2003?” “I see that. I see those.” Then at page 4750 I'm referring him to the fact there were two tufters but the first tufter is the one that we're talking about. It was commissioned in June – at line 6 – commissioned in June 2003 and the tufter was commissioned in April 2005, that's the second tufter. So the second tufter wasn't even part of the sales revenue in April 2005. And then I take him through the key learnings and recommendations.

O’REGAN J:
These were all in a report that he’d never seen before?

ELIAS CJ:
Had he left before the report arrived?

MS MILLS:
Yes, but he’d asked for the report.

O’REGAN J:
So what was the point of questioning him about –

MS MILLS:
And so I was just –

O’REGAN J:
But he wasn't a director when it was received so I just can't see why his views on it tell us anything.

GLAZEBROOK J:
Well if you go on he is explaining that the problems arose fairly early and why they arose so I suppose it's useful background. It says somewhere that he did know that they'd been difficult earlier but – quite early on.

MS MILLS:

And at page 4750 at line 14 I ask him, I adduce him to the key learnings and recommendations and note, “Production rates of the origin capital submission were a best estimate as the technology being used was untested for the production of carpet using wool, do you see that?” “Yes.” “And you were aware of that?” “Well when they say, when they say untest for production, yes. There was a manufacturing procurement test phase and an R&D phase but as I've described my recollection is that when the tufter went into operation there were difficulties in pulling the wool through the creel and that resulted in, from my background I was always interested in liability issues, that was altered in some serious discussions with the manufacturer about the configuration of the machine?” “Yes. This was yes, this was designed to be a breakthrough in product in competitive terms and that's described I think earlier in the justification. At the end of those the manufacturer responded and those issues were resolved, that's my recollection.” And they were resolved by the creel being correctly installed and changed and what actually happened.” And the next page, “There I think some more capable persons but I believe that in fact, I believe it was to do with the fact that the servos that were pulling the wool yard from creel were underpowered or whatever it was. I'm not really the person.” “But you knew the problem?” “When?” Says the Court. “When did you know about that,” I ask. “Well the tufter was implemented, the problem occurred very early on. This is my recollection again, it was used for manmade fibre so there was more or less into an equivalent position with Godfrey Hirst but the vision of creating wool mix carpets with this particular type of tufting technology was continued to be pursued by management and I believe from my recollection it was resolved and those carpets did get produced. Do you know when those carpets got produced? No.” Then at 4752, I refer him to the capital submission, “The more recent SESS capital submission for the purchase of the second SESS machine was taken into account and the production rates are less ambitious.” And he said, “All I can say that’s what’s written in front of me, I have no knowledge of that.”

And then page 4753, I take him through the evidence that I've already addressed you on the levels that were achieved from the CAPEX report. It refers to SESS Tufter was commissioned in June 868,602, see that. And then I take him through the presentation, the 8 April presentation and I put to him at line 26, "So the actual sales revenue generated by the SESS Tufter in June 2004 was not even a million dollars and the actual revenue for 2005 was $3.98 million.

ELIAS CJ:

Well where does he say anything that you regard as significant, Ms Mills? Like he does say, "I don't think it would have been regarded as material at the time" at 4754 but if you'd like to take us to anything that you think changes that, perhaps you should just go straight to it.

MS MILLS:

He certainly does, in his view it wasn't material, I have to accept that position Your Honour and that's at page 4755.

ELIAS CJ:

Well what are you wanting us to take from this evidence?

MS MILLS:

What I'm asking you to consider is that there's been criticism made of reliance on the value of the SESS Tufters to contribute to the sales and that it shouldn't have been introduced into evidence and there shouldn't have been cross-examination of these particular parties and that it should have been pleaded specifically as an untrue statement. The submission that we're making now is that it is not a standalone untrue statement, it's a contribution to the sales forecast failing to be met, making that an untrue statement and that there was no need to specifically plead that because it was a particular rather than a pleading.

ELIAS CJ:

Well I don't think you need to be too concerned about that perhaps and if it emerges in reply but really does it add materially to the submission you make on the shortfall in revenue and the significance of it and the principal argument that you're advancing that that made the forecasts misleading? So the position is disclosed that they're down, this is an explanation of why that should be so but it's not a standalone complaint as you're putting it.

MS MILLS:

It's not disclosed Your Honour, it's not disclosed at the date of allotment.

ELIAS CJ:

No I understand all of that, I'm just wondering how this fits in if you're not able to point to anything that shows that the problem with the tufting machine was such that that was a risk which was material which should have been disclosed and so far you haven't really been able to show us anything that indicates that that was appreciated. They realised they had a problem with it and it was one of the explanations for the shortfall in those months but there's nothing to indicate that this was going to continue to be a substantial problem is there? Because if there is take us to that.

MS MILLS:

There is no direct evidence on that point Your Honour, I have to concede that but the reliance is on the evidence of Mr Horrocks that this was an ongoing problem and it was –

ELIAS CJ:

Well it was a problem from the beginning with this machine.

MS MILLS:

And it continued to be a problem until after he left in April '05 and the machine had to be reconfigured and that was a lengthy period of time and so it was going to impact on the sales revenue.

ELIAS CJ:

And if they had known that it couldn't be fixed, it might have been something that should have been disclosed but there isn't any evidence of that.

MS MILLS:

No but the question is not whether it could or could not be fixed, it's a question of when it could be fixed.

ELIAS CJ:

Yes but if they didn't know that.

O'REGAN J:

It's a question of what they knew about when it could be fixed.

MS MILLS:

Well there is no direct evidence on that point.

O'REGAN J:

It takes us nowhere then.

KÓS J:

One other thing, Mr Horrocks gave evidence two witnesses before Mr Cameron and a few before Profession Van Zijl and a few before Professor Cornell, was this issue put to any of those experts who gave evidence on materiality?

MS MILLS:

Well there would've been no point in making that sort of point to Professor Cornell because his evidence is about efficient market area.

KÓS J:

Right so I'm wrong about that, but the other two?

MS MILLS:

And Professor Van Zijl's evidence was about the financial reporting standards.

KÓS J:

Well not entirely, he also gave evidence as to materiality in relation to shortfall.

MS MILLS:

Yes. I'd have to check that.

KÓS J:

Anyway what's the answer to my question?

MS MILLS:

I don't have an answer at this moment Your Honour I have to think about it.

KÓS J:

Well I only want to know if it was put to them.

MS MILLS:

It's been so long I just can't recall at this stage whether it was or it wasn't.

ELIAS CJ:

So does that conclude the tufting machine question?

MS MILLS:

That does conclude the tufting argument and that actually concludes my submissions Your Honour.

ELIAS CJ:

Yes the only question I have relates to, in your, I think I'm right that in your submissions but certainly in your oral submissions you haven't really relied on the SIP grants matter. Is that –

MS MILLS:

I'm not relying on it in terms of an important submission, no Your Honour I'm not. It's in the written submissions and the oral argument is focusing on the untrue statement.

ELIAS CJ:

So you're not making the submission that the one-off or the non-continuing payments which were taken directly to revenue are that was material?

MS MILLS:

The SIPs grants were including in the operating revenue line and the argument that was put forward before the Court of Appeal and in the High Court was that that should have been disclosed as an item because it went straight to the bottom line in terms of profit. That argument was not accepted in either the High Court or the Court of Appeal, so that point was never specifically appealed upon. In terms of whether or not the SIPs grants were relevant in assessing the revenue shortfall, they're not, they're not relevant at all because of course the revenue shortfall was caused by the lack of sales which wasn't attributed to by the SIPs grants.

ELIAS CJ:

So you're not making anything of it here?

MS MILLS:

Not specifically no. Are there any other questions?

ELIAS CJ:

No thank you Ms Mills.

COURT ADJOURNS: 11.25 AM

COURT RESUMES: 11.42 AM

MS MILLS:

I'm sorry to do one last thing. Yesterday Justice Kós asked me whether Mr Professor van Zijl –

ELIAS CJ:

Speak into the microphone please.

MS MILLS:

Well Professor van Zijl had been cross-examined on the MIP matter and I confirm he wasn't but there was significant cross-examination on Mr Tolan about MIP and I can give you the references. They are in his brief. No, that's incorrect. They are in the material that I gave you in the new bundle and it's at page 3896 to 3897 and again at 3898. That's just a simple question that I've been asked and I promised to come back to, Your Honour. Thank you Your Honours.

ELIAS CJ:

Thank you Ms Mills. Yes, Mr Galbraith.

MR GALBRAITH QC:

Now we've handed up another small bundle for largely the same purpose to try and assist with some of the material that wasn't in the consolidated bundle but there are one or two documents in there which I will take you to which aren't in any bundle because they have been created for the purpose of these submissions.

As you know there's a joint submission on behalf of the first, second, third respondent and I'm meant to be making submissions in relation to the paragraphs through to 74 but I doubt that I can escape without dealing with paragraphs 81 through 91 which relate to section 33. And I'm not making submissions in relation to tufters which is my friend Mr Weston's pet subject so he will be making submissions on that.

What I was intending to do just to indicate where I plan to go is I was going to make just some brief comments about materiality but really brief comments on materiality, then go to the factual issues which have been put before you in expansion of course on those and then come back to the scheme of the Act because – and it will include section 33 obviously.

While the appellant's submissions before you now say that materiality is relevant –

ELIAS CJ:

Sorry, so does that mean you're going to start with the facts and then move to the legislation?

MR GALBRAITH QC:

I'm going to do a little comment on materiality and then go to the facts.

ELIAS CJ:

I see, yes, thank you.

MR GALBRAITH QC:

But it will be a short comment.

ELIAS CJ:

Yes.

MR GALBRAITH QC:

So what I was going to say is the appellant's submissions yesterday acknowledged that materiality is relevant but of course how do you acknowledge that for the purpose of the obligation that they say exists under the regulations for disclosure of full information. So it still seems that we're in the world where provided there is an untrue statement and we of course challenged the Court of Appeal's finding in that respect, and I've got to come to that. It doesn't matter whether that statement objective is material in the sense that it would have induced entry into the purchase by the shareholder because of section 33 and so I will have to come back to why that is wrong as an interpretation of the role of section 33 in the scheme of the Act but it would, if I can say this, be a consequence which would be inconsistent with how the law generally deals with misstatements and if one thinks of the Fair Trading Act or *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 (HL) and if one goes back to the way the judiciary dealt with misstatements in prospectuses back to *Broome* and back to *Arnison* one sees that there is an objective assessment made by the Court and I did just want to take the Court back to *Arnison* for a moment because my learned friend quite

properly read from the Court of Appeal extract from *Arnison* but in fact when one goes to the actual judgment itself there's a little bit more that he says about it. Now that judgment is to be found in the appellant's bundle of authorities and it's tab 14 I think, volume 2, tab 14 and the page reference from which the citation is made is page 369 of the case which is 819 is the number at the foot of the page but 369 of the report and you'll recall that what Lord Halsbury was saying and I won't read that first part of that paragraph out, was saying, not much point cross-examining uphill and down dale and my learned friend made the comment that I'd done a fair bit of that but in any event, because either nobody will remember or they might decide they remember something that didn't actual happen and one can understand that.

So about half way down that first paragraph His Lordship says, "A person reading the prospectus looks at it as a whole, he thinks the undertaking is a fine commercial speculation, he sees good names attached to it, he observes other points which he thinks favourable, and on the whole he forms his conclusion. You cannot weigh the elements by ounces. It was said, and I think justly, by Sir G Jessel in *Smith v Chadwick* that if the Court sees on the face of the statement that it is of such a nature as would induce a person to enter into the contract, or would tend to induce him to do so, or that it would be part of the inducement to enter into the contract, the inference is, if he entered into the contract, that he acted on the inducement so held out, unless it is shown that he knew the facts, or that he avowedly did not rely on the statement whether he knew the facts or not." I think therefore the second proposition was made out but was induced to take the stock by misrepresentation and the extract from *Broome* which my learned friend read out from the Court of Appeal judgment makes exactly that same point and that's the basis for the Court of Appeal's determination at paragraph 69 the test or the approach to be appealed and you'll see in the Court of Appeal judgment they've set out in paragraph 67 the statement from *Broome*, then they set out the statement from *Arnison* but don't actually have that latter part of the statement and then at 69 they say, "In our view the proper approach is this, it is a question of fact whether an investor suffered loss by reason of an untrue statement, there may be evidence that satisfies the Court that a particular investor was not affected

in their investment decision by the untruth, for example the investor knew the true position but proceeded to invest but if there was no such evidence in reaching the view as to whether the plaintiff's investment decision was affected by the untrue statement the Court must ask itself whether the notional investor would have invested if they had known the true position. The materiality of the statement is obviously critical at this point. This test includes both subjective and objective elements. The Court asks first if the notional investor's investment decision was more likely than not to have been influenced by the untrue statement, that's first part of what Lord Halsbury was saying, if the answer is yes, the element is made out unless the evidence establishes that the particular investor did not rely upon the untrue statement which the second element which Lord Halsbury addressed."

Now that is both an objective and a subjective test and it explains if that's correct of course, why it is that the appellant has taken the but for approach and the section 33 approach because the overwhelming evidence before the High Court was that objectively that revenue shortfall which ended up being about 2.3 per cent, objectively it was immaterial and though it's part of the test and in fact Mr Houghton himself said that when in August the year end announcement was made in the annual report which showed there had been a shortfall as against the forecast projection he wasn't bothered by that fact, and so the contest between us really is materiality/section 33 but for, that's really where the contest sits between the parties as I see it at the moment. If I can go back to the factual issues and as –

ELIAS CJ:
And you will come back to, when you talk about the legislation as to whether the common law position has been modified?

MR GALBRAITH QC:
I will Your Honour but one has to interpret the scheme of the Act and I've got to come back to that.

Now I'm well aware that the Court is conscious, I suppose counsel is, as to the difficulties which there are in dealing with factual issues at a second appellant level when the facts before the Court now are relatively selective and I think can fairly be said to certainly be out of the full context of what was before the High Court, and I know the Court is conscious of that but it is even more difficult when the issues which are essentially factual or some of the issues which are essentially factual are run on a basis of assertions of fact based on accounting reconstructions which we will be saying weren't adequately put to fact witnesses in the High Court and the MIP submissions yesterday, you recall it was said there was a commitment to paying the MIP and it was written out after June, it was a monthly commitment. The margin submissions yesterday, I will have something to say about that and the tufter submissions this morning fall into that category, in my respectful submission.

And another feature of course, and it's inevitable of course when one comes to a second level of appeal is that the High Court Judge, particularly this was a three month trial, the High Court Judge was all over the facts from an early stage of the trial and that's very difficult for Your Honours and I'm sympathetic.

ELIAS CJ:
That's why we have counsel.

MR GALBRAITH QC:
I know, so we've got to try and assist. But where it comes up and if I could say it came up in a sense yesterday with the appellant's submissions because there are two important dates, there's the 5 May date which is when the prospectus was registered and there's the 2 June date and so being clear as to what was known at those two dates is important to assessing whether there should be some responsibility or whether there should have been something different said in the prospectus and that as a subject which discussed with my learned friend this morning.

So yesterday you were taken, you will recall, to a couple of statements from group operating reports and the first one that you were taken to was the April

group operating report and a page of that which talks about unders and overs, if I can use that expression. Now that's page of an 80-odd page document, that's one page out of the 80-something page document and the whole 80-odd pages were obviously before the High Court Judge. But that document, the April report in that page didn't come to a directors' meeting until well after 5 May and to show you that I just have to take you to that bundle I've just handed up and you will see items 13 in that bundle contains only two pages. The second page isn't in the consolidated bundle although you obviously find it in the case on appeal. So the first page says, "Board package for April 2004," and of course you think well, gosh, that's the April 2004 meeting. It wasn't. And that was a matter that became very clear at the hearing. If you go across to the index you will see why it wasn't because the index says, "Minutes of Board meeting 27 April," so it was obviously after the 27th of April and if you go down to item 8, "Documentation from Bell Gully entitled closing of public offer, covering memorandum, minutes of directors' meetings of 4 and 5 may 2004." So clearly the April GOP, that was the first document you were taken to yesterday, wasn't before the directors until after at least 5 May 2004 and the time to prepare this Board package. Now I can't at the moment unfortunately tell you precisely when that did come to the directors' attention but I can give you the reference to Mr Saunders' evidence in re-examination which I have set out an extract at item 12 in that bundle and at page 4590 and you'll see at line – I'm asking him about that document.

O'REGAN J:
Sorry who is this person you were asking?

MR GALBRAITH QC:
Mr Saunders who was the chairman Sir and you'll see at the top of the page I'm taking him to that document and you'll see the index, you'll see at about line 4, I'm asking about that index I've just taken Your Honours to and around about line 18 I say, "So is that any help to you as to when you might have received that bundle of documents?" Answer, "Talking about the package?" Question, "Yes." "Sometime after the 2 June 2004 meeting Sir." Now I'm not sure that's correct. My guess and I'm sorry it's only an educated guess is that

that may have come to the directors in late May, before the 2 June meeting but the one certainty is it didn't come to the directors before the 5 May registration of the prospectus and that was an issue that was discussed in the High Court and His Honour was aware of.

KÓS J:

Why would directors be given a draft set of minutes for the 2nd June meeting?

MR GALBRAITH QC:

The reason was Sir that there were formal drafts, there were formalities that had to be, and we can find them Sir and I will for you, there's a 1st June and a 2nd June. The 2nd June for example is a solvency minute. So it was the formalities that you have to sign off on if you're going to allot. So it wasn't a draft of what happened at the 2 June meeting. So what follows from that and I don't want to delve into the detail of it at the moment.

ELIAS CJ:

What did you put in your chronology by the way? Did you deal with this in your chronology?

MR GALBRAITH QC:

Mr Cooper says no, I'm sorry. So what we do know the directors had at 5 May of course were the minutes of the 27 April meeting which were also in that Board package. We do know they had, well sorry we know that they had a meeting on the 27th of April so they knew what they were told at the 27th of April, they got the minutes later on which records what was said at the 27th of April and the 27th of April is when they're told we messed up the calendarisation so it's not going to be a good month but May and June we think are going to be good. So 5 May, that's what they're told by management. Now they knew a lot more and I've got to come to the lot more they knew but just putting this in context at the moment.

Now what my learned friend, a slightly throwaway line, was well if the directors didn't know what was going on by the 5th of May, Mr Magill and Mr Tolan

would've because they got daily sales reports. Now I've re-read most of the evidence which was given in the High Court, I don't promise I read every page of it, I can't recall there being any evidence that Mr Magill and Mr Tolan by the 5th of May knew that May was going to be a bad month. Now there may be but I certainly don't know that. It was certainly correct they got daily sales reports, no argument about that but whether those daily sales reports before the 5th of May indicated any difficulty, I don't believe there is evidence of that but I stand to be corrected.

Now the second document you were taken to yesterday morning was the May group operating report and an extract from the May group operating report and my learned friend very clearly said that was part of the Board package for the 22 June meeting. So quite clearly the directors didn't have that before the 2 June meeting and they wouldn't because Mr Tolan said, when he was cross-examined, that to produce those group operating reports took at least it was a challenge and it took at least 10 working days after the end of the month. So it certainly wasn't there on the 2nd of June.

So what the directors had on the 2nd of June was what was explained to them by management and which his recorded in the 2 June minutes and we will have to go and have a look at those and my learned friend, Ms Mills, took you to a snippet view of those just a little while ago, so we will have to go back to that.

Why I have included under that tab 12 in that bundle after nine pages of re-examination which is a little unusual, is because a number of the directors were cross-examined, not unfairly at all, but uphill and down dale about various statements and various Board papers and what I attempted to do in re-examining Mr Saunders in those pages is take Mr Saunders through and identify what it was the directors actually had at these two various times and what the flavour was of the information they had. So I hope that's helpful to the Court. I don't pretend it's absolutely comprehensive but it gives you I think a, certainly a director's view as to their sources of knowledge and what they had at those two dates and at the end of it I asked Mr Saunders, we'll put the

minutes of 2 June to one side, what did you think at the time in that last page the information of why he came to the judgment which he did at that date, so I hope that's of some help to the Court.

But of course the other information which the directors had was all the information they'd gathered over the period of time they'd been directors of the company and also of course from the due diligence process which again I'm going to have to take you briefly to. So it's not just that something like we're under on Kensington carpet this month, it's got to be seen in the context, in the full context of what the directors had been told and had learned over that period of time and I do want to come to that. And so it was in that full context because we were there for three months in the High Court, that the High Court Judge came to the conclusion which he did that the issue of the shortfall in revenue told to the directors in June wasn't material and that was a determination confirmed by the Court of Appeal, of course, who were focused on the High Court judgment whereas here we tend to be focused on the Court of Appeal judgment but there was three months of assessment by His Honour in the High Court.

One of the matters which the directors were obviously conscious of and their evidence refers to is the progress which the company had made since the difficulties which it faced shortly after the acquisition of Shaw and Your Honour's have probably seen enough of the material, it's in the prospectus, it sets out that history after the enthusiasm of the Olympics in Sydney and the imposition of GST in Australia and everything got a bit difficult and the company's profit fell very substantially compounded by a strike in the following period which led to a disruption of supply, a loss of confidence among customers and a very significant dip in the financial status of the company.

And so I want to talk just briefly about the paragraphs 13 on in our submission which relate to the question of sales trend because the Court will be aware that the context in which this revenue shortfall was assessed was in relation to the trends and was one of the things the appellants have always said, well,

there was an adverse sales trend and therefore this should have been a signal that all was not well and in paragraph 13 we set out what the Court of Appeal said about that. My learned friend started yesterday by taking you to the paragraphs which the Court of Appeal had in introducing this issue and then you'll see in paragraph 13 we've set out what the Court of Appeal said but just take up a couple of points in paragraph 14 and I think His Honour Justice O'Regan may have made this point to my learned friend yesterday that that appendix B to the appellant's submissions has graphs which refer to a comparison of actual against budget and our respectful submission is that that isn't an indication of a trend that one would normally assess in relation to the performance of a company. You would assess the trend against a performance of previous year against this year would be the much more normal assessment of a trend and can I just ask you to, if you wouldn't mind Your Honours, just to have a quick look at one of the trends which is illustrated in the prospectus and it's page 82 which have very small numbers. It starts at 81.

GLAZEBROOK J:
You don't have the –

MR GALBRAITH QC:
Oh sorry I do, 9255. So it's part of the historical review of Feltex and how it had been tracking over time and you'll see on page 9255, the top of the page right-hand column, there's an EBITDA graph and you can see very clearly what happened after the acquisition of Shaw that EBITDA fell to a very diminished number and then you can see from there on the growth in EBITDA. Now in my respectful submission that is a trend, that most distinctly shows a trend but that is an upward trend and there was of course a deal of evidence given by the directors and by management as to the reasons for and their confidence in that trend.

The other matter, as we note in paragraph 14 again it was referred to yesterday, what was the difference between the forecast and the budget and as we say on the next page, the last sentence of paragraph 14, the revenue

figure in the forecast overall was about 20 million less than budget. It is correct that Mr Tolan was shown the volume figures from budget for the three months of the forecast and they were very close to the volume figures for forecast for that three month period and that's his acknowledgement that there was a close approximation. It was in relation to volume figures but the volumes in that three month period were in fact met. So quite where that takes one is difficult to see but the revenue figures overall were some 20 million lower in the forecast to the budget, overall and remember of course that the revenue projection in the prospectus is of course a 12 month projection, albeit built up from actuals to 31st of March and forecast for the final three months.

The second matter which we talk about in paragraph 15 and which is relevant again to submissions that were made yesterday is in relation to this issue about margin and you'll recall the submissions that were made yesterday and they hung off paragraph 107 of the Court of Appeal judgment and it was suggested that the Court of Appeal were wrong in paragraph 107 to say that – what they said was, "A shortfall in sales did not in any event result in an EBITDA," sorry, "in a shortfall in EBITDA or net profit after tax." Now they are speaking here actually about the circumstance of 2 June and what the directors were told so a shortfall in sales can of course in some circumstances lead to a shortfall in EBITDA because if your sales literally fall out of bed then you're in trouble. So there talking about the circumstance of Feltex and so what they go on to say, "This was in part due to the success of the strategy of changing Feltex's product mix away from lower priced and lower margin products in favour of higher priced and higher margin products. In other words what was important to the company's performance was not only how much carpet was being sold but what type was being sold. Feltex could make more profit from lower total revenue with the right product mix and although Feltex's sales revenue increased by 3.9 per cent from year end '03 to year end '04 over that same period the margin earned on sales increased by 13.3 per cent, the Judge comment on this aspect of Feltex's performance." And then he refers to Mr – sorry, there's a quote from the High Court judgment and Mr Thomas' evidence and a table which Mr Thomas produced which is the

same table that we've produced at paragraph 15 of our written submissions and as we say in our paragraph 15, as the Judge noted there, there was no challenge made in the High Court to Mr Thomas on that table or the evidence which he gave in respect of it. And he wasn't the only witness who gave evidence in relation to the strategy of moving from or focusing more on the higher margin range of the carpet products and being prepared to sacrifice if needs be the lower margin products.

And it was stated in the prospectus also and can I give you one other reference to add to the references already in paragraph 16, there's page 51 of the prospectus says it quite explicitly and we didn't have the reference to page 51 in our submission but on page 51 of the prospectus which is 9224, you'll see there, this is under Feltex strategies, a page on Feltex strategies. "Feltex has a defined set of strategies," et cetera, and do you remember my learned friend took you to this page. The second highlighted one down on the left-hand column, "Focused production to enhance margins. Feltex aims to continue to improve margins by focusing on developing sales with the greatest margin will be realised. Feltex has demonstrated a willingness to forego sales of the lower value carpets in order to shift production capacity and sales to higher value products." And when Mr Thomas was being cross-examined on the issue of value because, as you'd expect with a three month trial, I mean the focus moved from time to time he said, "Well I can always get volume all I've got to do is slash price. You can get volume but that's not what you're after you're trying to get profit and so you get profit by trying to increase your volumes and your higher margin products," and so that evidence was given and confirmed by a number.

Now what you saw yesterday though, you will recall the submissions that were made about and you were taken to the group trading results for the forecast period and you were shown that the dollar margins, I'm talking actual earned dollars, in the forecast period were under forecast for the first two months, April and May, but over forecast for June but overall were short. That doesn't at all affect the point that you're trying to and the evidence was they were achieving selling higher margin product but when you get a shortfall of

$8 million you're bound to have your forecast projections are going to be lower than, sorry, you're actual are going to be lower than your forecast projections.

ELIAS CJ:

The material we were taken to yesterday which no doubt you're going to comment on so you don't need to take it out of turn, was that in fact they weren't doing well in the premium products and the strategy, and it might have been the strategy, was not working and was – well, it wasn't achieving as forecast?

MR GALBRAITH QC:

Well that's inconsistent Your Honour, as you'll see with Mr Thomas' table that you see here which does show the increase in margins in the premium and mid sales compared to the previous year as against the mass sales where you see this strategy playing out, sorry and I should add this which isn't said here but it was said in the evidence, this table wasn't all sales, this was a table of residential sales, Australian dollars because that's a big part of the market and the evidence was, Your Honour –

ELIAS CJ:

Sorry, this is not all sales?

MR GALBRAITH QC:

No this is residential carpet or residential sales Australian dollars. One of the complications with Feltex is that it was an Australia and New Zealand –

ELIAS CJ:

Yes.

MR GALBRAITH QC:

It was listed here but it was an Australian company and about 80 odd percent of sales were in Australia.

KÓS J:

So this only relates to the Australian market, these figures?

MR GALBRAITH QC:

It was all residential sales but in Australian dollars.

KÓS J:

Right, okay.

MR GALBRAITH QC:

And then you'll find there are other –

O'REGAN J:

So it includes residential sales in New Zealand?

MR GALBRAITH QC:

Yes.

O'REGAN J:

But denominates them in Australian dollars.

MR GALBRAITH QC:

Yes as I understand it.

O'REGAN J:

What's the point of doing that though if you're reporting in New Zealand dollars?

MR GALBRAITH QC:

Because they reported both ways Sir. You may not have the full Board packs but the Board packs have both Australian dollars and New Zealand dollar reporting. The short answer is I'm not sure I have got a short answer but one of the postulations I would make Sir is that most of their sales were in Australia, much of their cost base was in Australia and so you really want to know that you've got enough Australian dollars to pay your costs before you

start translating back to New Zealand because the problem was of course if you get, it's all right at the moment the New Zealand is down but if you get the New Zealand dollar up and the translation effect they talk about, you apparently lose dollars but in the country where you need them you've still got them. So I think that's probably the reason for that. That's my explanation.

ARNOLD J:
What was the ratio of, it's in here somewhere but I can't remember, the ratio of residential to commercial sales?

MR GALBRAITH QC:
I'll come back to you on that Sir. It is in the evidence of Mr Magill I think. It might be in here to, the prospectus, somebody will give me that figure.

O'REGAN J:
But the figures that Ms Mills took us to yesterday on those reports in April and May, they were dollar figures, I agree and obviously if you have lower sales you also have lower dollar figure for margin but they also seem to indicate that the margins were lower in percentage terms than the forecast implied would happen.

MR GALBRAITH QC:
I don't think that's correct Sir but I may be wrong.

O'REGAN J:
Well it would probably help perhaps if somebody calibrated that for us. I would imagine it's just a division figure.

MR GALBRAITH QC:
Yes it is Sir, just a division but my memory is that we were still up in the 30s, low 30s, 31 or something like that and my memory also is that's higher than it certainly was the previous year Sir, where they were around about the 29s I think.

O'REGAN J:

Well I think – you're saying it's higher than the previous year but what Ms Mills was taking us to was was it higher in fact than they forecast it to be for the purposes of the prospectus.

MR GALBRAITH QC:

Yes I understand.

O'REGAN J:

Which is a different measurement.

MR GALBRAITH QC:

I just haven't got that document in front of me at the moment. Just to answer Justice Arnold's question, it's 9214, page number. In the introduction – and you'll see left-hand column 52 per cent of carpet sales are wool, 48 per cent manmade, 70 per cent to the residential market, 30 per cent primarily to the commercial market and there was a small amount exported and they also had some aircraft industry clients as well but you're talking pretty small numbers.

ARNOLD J:

So what page of the prospectus is that?

MR GALBRAITH QC:

It's 9214 in the case –

ARNOLD J:

No, the actual prospectus?

MR GALBRAITH QC:

My one hasn't got a number but on page 41.

KÓS J:

It's page 41.

ARNOLD J:

And the higher margin strategy was just aimed at the residential market was it?

MR GALBRAITH QC:

Yes.

ELIAS CJ:

Residential is more expensive, is it?

MR GALBRAITH QC:

Yes.

ELIAS CJ:

Or a higher value carpet?

MR GALBRAITH QC:

Yes because commercial tends to be –

ELIAS CJ:

Using synthetic.

MR GALBRAITH QC:

It's a much more of a bulk market because what they were looking for was trying to get into office buildings, et cetera, et cetera, or big apartment buildings.

ELIAS CJ:

So the table which you say wasn't cross-examined on is simply the comparison with the previous year?

MR GALBRAITH QC:

That's right.

KÓS J:

Well the middle band will be. Presumably the others are half year bands, are they, what are they doing?

MR GALBRAITH QC:

Well there's a half year band to 31 December 2003. There's a half year to 31 December 2004 and there's the financial year for the whole year to 30 June and we've got some other tables which we've included in that bundle which you will find under tab 1.

ELIAS CJ:

The handed up one?

O'REGAN J:

Is this your new bundle?

MR GALBRAITH QC:

The handed up one, yes, and these are –

ELIAS CJ:

Yes, I'm calling it new.

MR GALBRAITH QC:

If I say these are manufactured tables they are manufactured tables but we've given the references. Again we're talking about trends so what we tried to do here is compare last year equivalents with this year equivalents to see if there is a trend.

GLAZEBROOK J:

But wasn't the Court of Appeal saying something different there? They were saying that it didn't matter because the margins were better but actually the margins were worse than forecast, isn't that the point that was being made yesterday? So, yes, they might have been changing the product mix and they might have been successfully changing the product mix, that was supposedly

put into the forecasts and as at April and May that wasn't the case because the improvement hadn't been shown in those particular months. So that was the point that was being made.

MR GALBRAITH QC:

And the point that we're making is that if you're looking for a trend then you look for a trend over time and you compare it to a previous time, it's either up or down, it's got to be up or down against something. Now a trend against a forecast is as odd as a trend against a budget. The trend should be against what's actually –

GLAZEBROOK J:

Well no, the point that was being made was if you can see that in those months the forecast isn't being made the market might be interested in that because it might be concerned that there's going to be a downward trend?

MR GALBRAITH QC:

Yes and what I'm just trying to show to the Court from these tables is that you've got to look at that in the context which both the High Court and the Court of Appeal did that there can be ups and downs in particular months and Kensington may sell well this month or not sell well next month but you need to look at it in a more of an overall context to see if there is a trend one way or the other and what we said, and was accepted, and our witnesses said and were accepted, was that over that period, as you see from that EBITDA table over that period there had been a consistent march upwards in trend and, sure, they got calendarisation wrong in April or there was a bad January but still it was trending upwards as against what had happened the previous year and the previous year. So that's what these tables are intended to show in terms of both sales, volume and margin and you can see it in that first table as against the comparable quarter periods and again if you go across to the next page –

GLAZEBROOK J:

I'm just not sure it answers the point because yes there was and that was what was being forecast on and then in those two months that wasn't being accepted. I mean it might be there are other explanations for that.

MR GALBRAITH QC:

Well we've got to go and look at those Your Honour when we go to the 2 June meeting but if we can just, if you Your Honour would indulge me, just stay with the trends at the moment because these are the figures, these are the comparators with what had happened previously and what was happening now allowing for April and May not, you'll see we've got third quarter, we've got fourth quarter, allowing for those you can still see consistently that it's above the previous year. Now I understand the point Your Honour is making to me but how does that compare to forecast? Well we'll have to have a look at that.

GLAZEBROOK J:

Well also above the previous year, I mean I can see the point, but the previous year they weren't doing very well at all were they?

MR GALBRAITH QC:

No they did extremely well. That EBITDA chart just shows it was a significant increase on the year before. So what you had was an upward trend and this was a continuing upward trend, as long as you don't try and narrowly pick a particular one week or one month for which there may be an explanation but I do have to deal with the explanations and you'll see also and it's got a bit out of place I think, behind tab 6 there's a graph of sales year to date in March and the variance on the prior year and again that illustrates what I would with respect would suggest is a trend which is quite clearly upwards and as I say that was the evidence of more than one witness.

KÓS J:

I don't understand that graph, margin exceeds sales, gross numbers.

MR GALBRAITH QC:

That's the calculation of the margin in those periods and so it really comes from – it's a graph of a representation of what's in those earlier tables Sir. So it's the margin which has been earned in those periods as against sales in those periods.

KÓS J:

It seems improbable. I think we'd all like to be in that business.

GLAZEBROOK J:

Is it because it's a variance?

MR GALBRAITH QC:

It's the variance to last year.

KÓS J:

I'm sorry variance, right.

MR GALBRAITH QC:

And so the margin was improving which is the point of Mr Thomas' table over the previous year. They were succeeding in moving from lower margin to higher margin and they were earning more profit.

ARNOLD J:

Just on that, presumably the forecasts that were prepared for the prospectus took that into account, that change in strategy.

MR GALBRAITH QC:

Yes.

ARNOLD J:

And yet despite that you do have the shortfall.

MR GALBRAITH QC:

Yes which is why Sir we've got to have a look at that but what you'll recall and yes what the evidence was, was that the forecast that was made for the fourth – there was evidence about seasonality. Second quarter and fourth quarters tended to be the best quarters and so the forecast that was made for the fourth quarter was pretty close to what had been achieved in the second quarter and the evidence was that was a reasonable assumption to make. It wasn't met, we know that and we've got to look at the reason why it wasn't met.

ARNOLD J:

So how was that a reasonable assumption if it was known that second quarters generally perform better?

MR GALBRAITH QC:

The history was that the second quarters and the fourth quarter were the two best quarters and so that was a basis for the forecast and I don't think anybody quarrelled with that, I think both sides accepted that was correct, and one of the obvious reasons is you have Christmas, and January is a disruptive time but everybody is trying to get stuff done by Christmas so that's good for the second quarter. One of the reasons for the fourth quarter tending to be good is that people are trying to wrap up their financial year, for example, in this case there was going to be a price increase in the 1st of July and incentives are provided to customers so if they purchased a certain volume of carpet during the year then they will get an incentive and that's all based on a financial year, so those are the sort of reasons.

So if you just look quickly at our paragraph 18, what the prospectus showed was that sales revenue, and again perhaps just to explain, you will see adjusted for discontinued operations. They sold a carpet retailer called Andersons, that was 19.6 million of revenue that was sold and they closed the rubber underlay plant, so those adjustments had to be made in the financial statements, comparatives but the sales revenue once you adjusted that was 301 million in the financial year 2002, 313 in 2003 and forecasting sales in

2004 of 330. Now the actual sales were only 322, we know there was almost $8 million shortfall but that trend was an increase of 3.7 per cent and a further increase of 3 per cent from ’03 to ’04 achieved in part by improving margins. Now at the half way point, if we just look at our paragraph 20 –

ELIAS CJ:

You say achieved in part by improving margins, are you hooking us into some evidence on that or are you just relying on the trends?

MR GALBRAITH QC:

No, I mean that is the evidence, for example, of Mr Thomas’ table. I mean there were improving margins.

ELIAS CJ:

Well that's the trend really.

MR GALBRAITH QC:

Well that's not a trend that's an actual measure that the margin percentage was –

ELIAS CJ:

Do we know how it was made up or anything like that?

MR GALBRAITH QC:

Well I'm not quite sure what Your Honour means by that. I mean it was made up because, as you will see in Mr Thomas’ table, premium and mid-sales margins were up, mass sales margins were down, which was the strategy, and so compared to last year there had been an increase in, percentage increase in margins but if Your Honour means do we know how it's made up, I mean product by product, not really.

ELIAS CJ:

No, there wasn't – there would have been evidence of that I suppose?

MR GALBRAITH QC:

Well of course, well as I say, the group operating reports each month were 80-odd pages, I mean they went through blow by blow every type of carpet and the group operating report also had – I'm sorry I don't want to use the word “trends” again because it wasn't called trends but it was called future something or other but let's use that term trends for a moment, and it went through and it looked at residential New Zealand, residential Australia, commercial New Zealand, commercial Australia, it had statistics about the number of new building permits which had been taken out, what was expected in the economies of these countries, every monthly report had that and it projected forward as to what you could expect in the forthcoming time, and you will see in that re-examination of Mr Saunders, I took him to only a couple of those but there were pages and pages before the directors every meeting that didn't just look at what had happened that month or the previous month but looked at what was projected to happen in the carpet business and in the economy generally which was important to the carpet business and of course when one thinks of carpet, sorry, this will probably sound very obvious, but selling carpet depends upon people building new buildings or renovating old buildings or people buying new houses or that sort of thing, they are major, the carpet itself may not cost the hugest amount but there are the accompanying to quite significant expenditures and so the economic conditions are very important to the carpet industry and one of the things that the prospectus talks about is the importance of both consumer and economic confidence and I’ll come to that in a moment because it is a significant part of the explanation as to why things turned out not to go well down the track.

KÓS J:

But just on paragraph 107 of the Court of Appeal’s decision, Mr Galbraith, are you going to take us to page 2 of your graphs in tab 1 because that seems to tell us something?

MR GALBRAITH QC:

Yes well I’m going to have to come back to the 2 June meeting Sir because that’s when they discussed it but if you look at those – at page 2, is that the

one that focuses on quarter year periods rather than individual months that you're looking at?

KÓS J:
Well it does but it also shows margins, reading it for each month and through the relevant period.

MR GALBRAITH QC:
Yes.

KÓS J:
Now we don't have a comparison of the forecast but again you can pick some trends perhaps in the short snap there.

MR GALBRAITH QC:
Well if you look at the second page, that margin is more important than sales, you can see how there are two months where the variance is down on last year but generally it's marching forward and you've got a margin in that third quarter of 9.6 per cent and 6.4 per cent in the fourth quarter and an overall margin for the second half of 7.8 per cent. So margins are being achieved and they're positive as against the comparable quarters of the previous year or the comparable months of the previous year in those quarters. So provided you don't, and the terms that was used by the Court was cherry pick, provided you don't cherry pick too narrowly you can see what is a, at that time, a constant positive achievement of the strategy which was resulting in higher profitability for the business on a relatively small amount of gross sales increase and that's why in paragraph 20 of our written submission we saying that the financial reporting period, the six month reporting period, the sales achievement was 5.3 million ahead of the same period the previous year. The EBITDA had gone up by 8.9 million, the profit by 10 million. Now those are, with respect, compared to where they were coming from in that low period was a significantly improving financial perspective and there's reference I think in the judgment to Mr Thomas emailing somebody saying the business was humming. Oh there we are in paragraph 21 we've set it out.

Now in the quarter to March, paragraph 22 says, when you calculate the figures to the monthly management accounts because there isn't quarterly reporting, the sales and revenue had not lifted significant from that which had been in the first six months but the margins were ahead had increased and the EBITDA was ahead and the profit was also ahead at 12.75 million and again those references you can see that we've given there and so it continued for the full year where sales were 9.2 million ahead of the prior year, the year on year, so it had increased from the second half being 5.3 ahead to being 9.2 ahead, EBITDA and profit had also continued to improve. So constantly through that year, six months, nine months and 12 months, there was a lift on what had been achieved on the previous year and that continued, the improvement in margins continued through to the end of December 2004 and you will have, I think in your electronic case, the annual report for December 2004 in which Mr Saunders reported that EBITDA was up by another 6.9 per cent despite the fact that mass sales were down but the improved product mix had assisted, but also flagged the concern because that report of course is produced after December 2004, it's produced nearly 2005, the concern that the Australian market situation might be challenging for the next six months which is why I asked to be included in the bundle which you've got, the separate bundle, tab 4, and evidence was given about this at the hearing.

Tab 4 is a Westpac market report, as I say, which evidence was given about in March 2005 saying that consumer sentiment had fallen 16.6 per cent from February to March. The biggest percentage fall ever recorded in the history of the survey goes on to explain some of the background to it but says that this is, and I'm using my own term, extraordinary as compared to the last time there had been a fall prompted by Reserve Bank increasing official rate where the average fall in confidence between May 2002/2003 was only 1.1 per cent and when there'd been a fallback in March 2001 that had been very quickly been a recovery, and it goes on to say the move, this is about middle of the page, "The move may not be a classic overreaction by consumers," it goes on to say, "Consumers are likely to remain tentative. The consumers concerns

are highlight in response of mortgagees and tenants. All components of the index are down. The economy over the next five years fell by 16 – it's either 15.6 or 16.6 per cent and a warning to retailers already experiencing weak retails sales," and so the evidence was that what happened, the New Zealand market held up but the bottom fell out of the Australian residential market and for other reasons which we traversed before the High Court, including falling out with the ANZ Bank, Feltex got pushed into a situation where the bank appointed a receiver because it wanted to sell the business and get back its lendings and sell the business to Godfrey Hirst which is rather ironic because in about October of the previous year the directors had been considering whether they might not make a bid to take over Godfrey Hirst so there was a substantial turn round in circumstance.

So, as I say, I've got to come back and deal with the specifics of 2 June and what the directors knew then but the background to 2 June is that material which I've just taken you to which does show a steady progression on the part of the company and, as I want to now take you to, the information available to the directors through the development of the prospectus, the due diligence process all confirmed that.

And so if you wouldn't mind just looking in the written submissions to paragraphs 26 on, we are now talking about the preparation of the forecast and how that was done and the information, as I say, which the directors had leading into the prospectus launch and so at paragraph 29 summarises Mr Tolan's evidence where he described how he'd built up the forecast and the '05 projection and he explained that was done by a bottom up model of looking at the, identifying the sales and costs for each month, obviously based on historical knowledge, adjusted for anticipated changes. All the relevant sales managers were involved in that process and there was a final review and there were the presentations made to the Board that my learned friend Ms Mills talked about this morning on the 1st of April and the 8th of April and she took you of course to the presentation made on the 8th of April and you can see the type of information that was contained in that. The final version was completed on the 30th of April and the prospectus as you know was

registered on the 5th of May. Now between those two dates what happened was, as part of the due diligence process, was that each of the senior managers responsible for residential sales, New Zealand residential sales, Australia commercial sales et cetera and the other categories that the directors had to be satisfied about were all subject to due diligence interviews and those are all in the consolidated bundle I believe and I don't want to force on the Court a sort of reprise of what we went through obviously down below but one looks at say Mr Magill's or Mr Lyon's he was the residential New Zealand manager, you'll see that they are detailed interviews and they are positive and they are confirmatory of what I, with respect, submitted to you about the trends and where they believed the business was going to. Now not all the directors were on the due diligence committee but all the directors got copies of the due diligence interviews and a number of the directors attended those due diligence interviews, not necessarily all of them but various of them but they all got those due diligence interviews and then as the prospectus was developed and before it was registered each proposition in the prospectus had to be signed off by the relevant executives in the business to confirm their belief that those propositions were correct. So again in the High Court, it's not before you, but there is a voluminous document where each proposition is signed off by not necessarily one but maybe two or three of the executives and again of course the due diligence committee knew that as part of the due diligence process and the directors knew that.

ELIAS CJ:

I was wondering to what extent this is in contention Mr Galbraith.

MR GALBRAITH QC:

I'm not sure whether it's in contention.

ELIAS CJ:

It's not really being put that there was no basis or no reasonable basis for the forecasts at the time they were made.

MR GALBRAITH QC:

Well I think it was being put by my learned friend.

ELIAS CJ:

Originally.

MR GALBRAITH QC:

Yesterday that the prospectus as at 5 May was untrue because of omissions and as I understood it continued to be untrue during the whole time the offer was out there and was also untrue as at 2 June. So as one of the, when you look at section 56 and we haven't actually looked at 56(3)(c) yet, is the reasonableness of the directors' belief and my respectful submission is that the reasonableness of the directors' belief has to be assessed in relation to what they did know and I'm simply describing to you the basis upon which they did know what they signed off on which was the prospectus and that material actual isn't before you.

KÓS J:

This is the due diligence defence that you deal with later in your submissions as well isn't it?

MR GALBRAITH QC:

Well I'm not going to do the due diligence defence but forgetting about the defence itself because it's a separate defence of course but the fact of it is that we are looking at whether, it's now suggested there were omissions that were required to be – disclosures required to be made by the regulations which wasn't an argument that we faced previously and it's not pleaded in those terms either but we're now faced with, we were meant to have disclosed what happened in April, we were meant to have disclosed what happened in May and then it goes to tufters and other things.

GLAZEBROOK J:

But that's all you're facing I think what the Chief Justice was putting to you. I mean we've had all of this and we understand that but what's being faced now

is pretty now in terms of because you had those results, those should have been disclosed.

MR GALBRAITH QC:

I understand Your Honour but the consideration for whether, if we go back to tufters, which I'm not going to talk about, where you disclose about tufters really comes back to the sort of questions that Your Honours were asking my learned friend about, was it just a temporary breakdown, did it get fixed, that sort of thing. So you've got to know the context to know whether it's something that you're going to disclose. If your trend is remorsefully upwards and you have a blip for a week, well, I was going say "so what" but that's not material. So measuring materiality and my learned friend says materiality is important as to what you disclose, it's got to be material, you've got to look at it in the wider context of was this something that was important, did it show that things were going south.

ELIAS CJ:

Well I understand that but it is important for that context but I'm just wondering why it's necessary to take us at length through what was done in preparing the forecasts, except as they affect the particular matters of criticism that are advanced. I mean you're right that a trend upwards would give you confidence that setbacks may be temporary but does it go much further than that?

MR GALBRAITH QC:

Well in my respectful submission it goes a long way further than that because that's exactly what you'd assess it against. We're trending upwards, now does what's happened yesterday or tomorrow we think, does that make us lose confidence or feel that there is a risk that we should disclose or are we comfortable that that is but a incident that happens in the business and it's important –

GLAZEBROOK J:

To be confident of that, no matter what the trends have been in the past, you would want to know why there were those dips and the explanation for it.

MR GALBRAITH QC:

Yes absolutely.

GLAZEBROOK J:

And also presumably there's nothing in the market that suggested that the turnaround was going to cease but I don't think you're facing allegations, I don't think the allegations is of that kind.

MR GALBRAITH QC:

No Your Honour is quite right but it is important of course for 2 June because at 2 June the directors were faced with advice that, for the reason that we'll have to have a look at, that the revenue wasn't going to be met. Now sitting as a director you can imagine the director would be saying, "Well is this something which is more than a one-off and part of the reason – part of the context in which they'd assess that is how comfortable do I feel about where we are, we we're travelling to and everything else I've been told, is this something that makes me lose confidence in that and it's got – well I said that's objectively the reasonable way the director would assess it. So all I'm saying –

O'REGAN J:

Well it's more do investors need to know this.

MR GALBRAITH QC:

Yes, well that's the ultimate suggestion which is being made yes Sir but the directors have to make a judgment on that and they'll make that judgment no doubt in their context and one of the witnesses you may find helpful in that respect and you'll remember my learned friend Ms Mills and I'm not sure about Mr Carruthers has referred quite a deal to Ms Withers' evidence and the reason, I think there's a twofold reason for that, one reason is that she had a

notebook, that's really the reason my learned friend was referring to it but the second reason was that Ms Withers came on the Board very late in the piece. She was invited on the Board because she had experience at Auckland Airport with a IPO there and her evidence was that she came on the Board or agreed to come on the Board, she undertook a pretty comprehensive due diligence process herself, went and inspected the factories, talked to Mr Magill and Mr Tolan and asked questions et cetera and wrote a lot of the answers down in her notebook and because she didn't have the same background in the business that the other directors did, she quite clearly asked questions and wrote down in her notebook the things that she was told at the various meetings and her evidence was, and Your Honours can place what weight you like on it, but her evidence was that she was comfortable at each stage of this process that this was being done rigorously and that the explanations she was receiving and writing in her notebook were credible and on the basis of the investigation she'd undertaken appropriate. So the only reason I suggest that, in a way she's almost, she's not an objective observer because she's actually there doing it but she wasn't part or the people who'd been throughout, she came from the outside with a new perspective and her motivation for accepting the appointment to the Feltex Board was, as she explained, that her background wasn't in manufacturing and she wanted to gain experience in manufacturing, she saw Feltex as being an appropriate place to do that so she was asking questions and trying to find out and learn. So you may find assistance in Ms Withers' evidence and in her answers to cross-examination.

ELIAS CJ:

It is time. Is that convenient?

MR GALBRAITH QC:

Yes, that's fine.

ELIAS CJ:

We will take the adjournment, thank you.

COURT ADJOURNS: 1.02 PM

COURT RESUMES: 2.18 PM

ELIAS CJ:
Thank you.

MR GALBRAITH QC:
Thank you Your Honour. Just very quickly, paragraph 32 in relation to the other background material which the directors had. We refer to the Ernst & Young advice. Would you mind just noting in the fourth line of that 32(a) we talk about two reports from Ernst & Young. One report was the 28th of April, it went to the due diligence committee and one report was the 3rd of May and went to the directors so those reports were available as at the registration of the prospectus.

And (b) we're speaking of interviews which took place, a meeting on the 1st of April, and that type of information which was obtained there was, as I said this morning and couldn't put the title to it, part of a section in the group operating reports each month under a heading, “Future Performance,” which went through those various categories of residential, commercial, et cetera.

Now I want to go to the 27 April meeting in a moment but just before I do that can I just pick up that issue about margins in this latter part of the period, and take you to four of the group management trading result reports, and the first one I want to take you to is in that collected bundle, it's tab 242 and in the case its 6729. So it's either tab 242 or 6729.

ELIAS CJ:
Volume 3, is it?

MR GALBRAITH QC:

Yes, Your Honour, these are all volume 3 I think. So this is the group management trading results for March and the reason I'm going to that is because it was the March group operating report that was in front of the directors at the meeting on the 27th of April leading up to the 5 May registration of the prospectus and you can see the numbers which were in there but just looking at the margin percentage on the left-hand side, carpet volume sales, cost of sales margin and there is a dollar margin and there is a percentage margin.

ELIAS CJ:

So which page?

MR GALBRAITH QC:

On 6729. So on the left-hand side, carpet volume sales, cost of sales margin, margin percentage and so alongside margin is the dollar amounts and March was a good month and so the dollar amounts exceeded budget in last year. But you see the percentages, actual is 32.1 against a budget of 29.2 and last year of 28.4 so clearly margin both in dollars and percentages was mix if you like to talk about it that way was being met. Now this was the report that was before the directors when they had their 27 April meeting and I want to come to that meeting in a moment.

Now the next one, if Your Honours wouldn't mind, and still in volume 3 under tab 240 or 6406. So tab 240 or 6406 is the same report for the month ended April which was, as you know, an unhappy month because of calendarisation, et cetera. Now as you also know they wouldn't have this report at 5 May but despite what Mr Saunders said, I think they would have had it around by 1 or 2 June I would think. So it's not relevant to the 5 May decision but it certainly may be relevant to the 2 June decision. And if you look at that –

ELIAS CJ:

Can we accept that they had it by 2 June?

MR GALBRAITH QC:
I think so, yes, Your Honour, I think that's there.

ELIAS CJ:
Yes, I would have thought so.

MR GALBRAITH QC:
I think that's there. So if we look in the same item in margin again you will see that for margin dollars, unsurprising because we know that they didn't meet forecast that month, it's 8305 as against budget 8666 but the forecast was higher, 9630 and last year was 8138 so they beat last year in dollars but were down on forecast.

But the margin percentages were 34.2 actual as against a budget of 28.4 and forecast at 32.3 and last year of 29.6, so still the margin percentages that the mix is still consistent with the strategy which they pursuing but as you see from some of those tables that we referred to before, it was on the mass side that they were falling off in volume and therefore in sales dollars.

And then the next document –

O'REGAN J:
Can I just stop you there?

MR GALBRAITH QC:
Yes, certainly Sir.

O'REGAN J:
Because yesterday when we were looking at this same document the document the figure that Ms Mills was taking us to was the one further down the page which was the margin after all the overheads had been allowed for?

MR GALBRAITH QC:
Yes.

O'REGAN J:

So you're taking a different margin?

MR GALBRAITH QC:

Yes, because this is the margin that when they're talking about a margin in terms of sales mix this is the margin percentage that they're talking about, what's the margin we're making on our sales less direct costs?

O'REGAN J:

So you say attributing overheads is a distortion of what you mean by margin?

MR GALBRAITH QC:

It was another figure they looked at but it wasn't the figure – when they were talking about their margins they were talking about the normal sort of margin you say. "I'm selling this for $10, it cost me $8 to produce, I'm $2 up so I've got a, whatever that is, a 20 per cent mark up." So that was when they were talking about percentages, that's what they were talking about. And then if we look, still in volume 3 of that consolidated bundle, if we look at tab 243 which is 6911.

ARNOLD J:

Just before you leave that one, the more alarming figure or the marginal variance surely is the sales volume variance and we've spent a lot of time on margins probably because the Court of Appeal focused on it in paragraph 107 but it's really the sales volume that's the thing that we've got to drill into more deeply isn't it?

MR GALBRAITH QC:

When you're say sales, you're actually talking about the carpet volume Sir or sales?

ARNOLD J:

I was talking about sales, line 2 where the variance is five million and obviously this margin only part of that, the margin is only one million.

MR GALBRAITH QC:

That's right, yes, yes well what that is what we've got to talk about Sir when we come to 2 June because that's what they knew by 2 June. So if I can come back because I want to talk about that but the other thing though Sir to draw from that is that as the evidence was and as the Court of Appeal and the High Court recognised, that your sales can be down in total dollars if your margin is up, as you say, it in a sense insulates you a little bit from the lower sales dollars because if you're selling five million less at only 10 per cent margin then you're going to be in trouble but if you've got a 40 per cent margin then you're going to be cushioned I suppose is perhaps the word. Now the tab 243 in 6911 is the equivalent for May.

ELIAS CJ:

Are you going to come back to talk about the commentary on these?

MR GALBRAITH QC:

I wasn't but I will. I'm certainly going to talk about the 2 June advice, yes.

ELIAS CJ:

Right, oh well maybe we can deal with at that time too thank you.

MR GALBRAITH QC:

So this is the May equivalent and you'll see there that now in May they didn't have this at 5 May obviously. They didn't have this at 5 May or 2 June because this accompanied the 22 June Board pack so this wasn't knowledge which the directors had at 2 June. There's absolutely no evidence that they had this but again, because Your Honours were asking about margin deteriorating in this time, you'll see the margin percentages, in fact it matched last year, it was higher than the forecast percentage which was what I was being asked about but the directors didn't have this at 2 June and then the final one which is tab 244 because put all this margin in perspective, 244 at 7803.

GLAZEBROOK J:

I mean I can understand they wouldn't have the detail but it seems odd that they'd be prepared to have a meeting, especially around a float where all the figures were out of date.

MR GALBRAITH QC:

Well because you have to have your meeting after – you do the prospectus which they did and they did that on the basis of the information they had at the end –

GLAZEBROOK J:

Well no what I was really asking, it seems odd that you'd go well this is fine we're out of date, I can understand not in the detailed paper but surely they'd have – have we got any evidence of what they had updated? I just wonder what you're making of this that's all.

MR GALBRAITH QC:

No well I'm really answering Your Honour's, I think it was Your Honour's question to me about whether the margins deteriorate over the three months, I'm just really trying to show the margin percentage actually did stay up, that's really what I'm talking about.

GLAZEBROOK J:

No, that's absolutely fine.

MR GALBRAITH QC:

But yes I'll come back to what they had at both the 5th of May and 2 June. So this is the year to date, so this puts in the whole of the year perspective at 244 or 7083 is the Supreme Court bundle reference.

O'REGAN J:

Well 7082 is the month of June, where it's slightly behind.

MR GALBRAITH QC:

That was slightly behind, 7083 is the year, so you get the year picture and it's marginally heading of the forecast, certainly ahead of budget and certainly ahead of last year. So again in my respectful submission it's – now they didn't have this, of course, they didn't have this until way after 2 June either but there was no reason for them being told anything negative about the margins or the mix that they were achieving because quite clearly it was in front of forecast other than, as Your Honour Justice O'Regan has just mentioned.

So I wanted if I may to go back to the question of the director's position as at 5 May which is the registration, is really evidenced by the Board minutes for the meeting of 27 April, subject that they got some additional information from Ernst Young after that and those Board minutes of 27 April are again in the – they're at T243, so they're in the consolidated bundle at 243 or at 6855. So that was a meeting 27th of April and you'll see on the front page of the minutes that the group operating report that they had for that meeting was the March 2004 operating report and financial results for a good sales month, with a good sales mix. And there's the report or the forecast about April. April is forecast to be a difficult sales month but the shortfall will be picked up in May and June. Then there's a discussion of various ranges of product they had out there. Carpet Call has agreed to take two, LCL, SDN, synthetic dyed nylon ranges and two new polypropylene ranges, commercial export, aviation, cash flow, human resources et cetera.

Then there's discussion on the next page about the IPO offer document, the due diligence committee management interviews were of a high standard, due diligence process did not highlight any new issues and, you can actually see on the next page there's this reference to the LCL tufter CAPEX proposal being approved and you'll see that the strategy meeting scheduled for 1 June was cancelled and a two day strategy meeting scheduled for 21, 22 June which was where of course the April group management report actual would be in front of the or was in front of the directors.

So in my respectful submission, in respect to the suggestion that at 5 May the directors or the prospectus was untrue or there was anything misleading in it, simply isn't borne out by any of the information that was actually before the directors at that time or the due diligence committee and the information at that time was yes April wasn't going to be a good month but May and June would get them there. So in my respectful submission it's a long bow to suggest that there was some responsibility on the company and the directors as at that date to make some explicit statement about the calenderisation problems which had arisen in April.

Now one then has of course to go forward to the position of 2 June which we pick up in paragraph 36.

GLAZEBROOK J:
It is a rooky mistake not to pick up calenderisation issues, isn't it?

MR GALBRAITH QC:
No argument Your Honour, I don't disagree but it apparently is what happened.

GLAZEBROOK J:
Well with the careful process that supposedly goes on with all of this it's perhaps even odder.

MR GALBRAITH QC:
Well I might have turned to the wrong page of the calendar, I really don't know. I've certainly have done that once or twice. So the 2 June meeting is the allotment meeting, of course. In my respectful submission, there is nothing before, or there was nothing before the Court to suggest that there was any new information that certainly came forward to the directors prior to the 2 June meeting other than, as I said before, I believe they would have got the April minutes and the April group operating report. So that meeting was held on the 2nd of June and I would like to take you to the minutes for that meeting and there in the consolidated bundle at T369 or in the case at 9812.

O'REGAN J:
What tab is that?

MR GALBRAITH QC:
Tab 369 Sir. Now this is the minutes of the due diligence committee and you will see on the first page at 9811 who attended. There was Mr Saunders, Mr Tolan, Mr Kokic, Mr Thomas, Bell Gully Legal, Mr Rowe, who was a member of the committee on behalf of Credit Suisse and the observer were Mr Magill and Mr Mangini and Julie Simon from Feltex, Forsyth Barr, First NZ Capital, two representatives from Ernst & Young and Herbert Greer who were Australian solicitors looking at the Australian legal end of it. It starts of this, an explanation of what the purpose of the meeting was which was to conduct bring down due diligence to ascertain whether since the date of registration there had been any material adverse circumstances which would cause the offer document to be false and misleading. That's of course the express provision in the Securities Act about material adverse circumstances and again we will probably end up discussing that when we talk about the scheme of the Act.

Then there's management updates, the Chief Executive Officer, Sam Magill, gave the committee an update. He advised forecasts were based on the market knowledge available at the time the forecast was set. The company is set to meet and in fact exceed the 41.6 EBITDA forecast, however, he advised the company might not meet its sales forecast for this period due to the following reasons: the newly introduced growth rebate scheme for retailers result in good sales for March, however, the market slowed in April and May and retailers have taken longer than expected to move the stock they purchased in March. In addition the schedule April plant closes for maintenance resulted in the company not being able to deliver certain sales orders by the required delivery dates. And then secondly, unforeseen production issues which in turn impacted on delivery time including issues with solution dyed nylon which led to approximately a $3 million shortfall for April/May. The solution dyed nylon issue has now been resolved. I won't steal any of Mr Weston's thunder in relation to that advice.

So the amount of shortfall compared to forecast will be in the order of 7.5 to $9 million, less than 3 per cent of annual sales. Now then he explained that Rod Lyons who is the New Zealand residential manager and Ms McCarrisson-Wilson who is the Australian residential sales manager, their discussions with key retailers indicate the market is lifting with production issues now resolved retailers shooting for their fourth quarter rebate in June it is believed the policy will recover some of the April/May revenue shortfall and may in fact be two to $3 million above the June revenue forecast and it was confirmed the company had the production capacity to both make up some of the revenue shortfall and meet a peak in new orders in June.

Sam is confident that the sales and other projections for the year ended 30 June 2005 will be met. The company will maintain its strategy not to discount sales but rather to focus on achieving margin, the price increase from 1 July should increase sales by approximately $8 million not projected for and Sam is confident that the price increase will stick. Then discussion about the LCL machine being fully booked et cetera. Perhaps third sentence, the additional sales from the first LCL tufter and the woven plant restructuring should contribute approximately $5 million in EBITDA for the year ended 30 June 2005 which has been included in the projection for 2005. However the additional EBITDA contribution of approximately 2.5 million from sales production from the second LCL tufter has not been included in the projection for 2005. With the IPO process now completed management focus on running the business and advise the committee that he is confident the company will meet EBITDA and sales projections for 2005. He believes the business is in the best shape it has ever been. Then he was asked if he was aware of any factors that may adversely impact the value driving line items, such as EBITDA and net profit as disclosed in the forecast and projection which would result in the value driving line items not being achieved, confirm not aware of any factors. Confirmed in his view the fact that the company may not meet the sales forecast for the year ended 30 June but the indicated amount was not a materially adverse circumstance for the company and the forecast EBITDA should still be achieved. Noted that the offer document

focused on forecast EBITDA results which the company is confident will achieve rather than forecast sales and then Mr Kokic confirmed that, you'll see there those bullet points. Second bullet point, “The new production equipment has been installed and is now fully operational.” The third bullet point, “The other various…”

GLAZEBROOK J:
But what are they referring to there, the LCL?

MR GALBRAITH QC:
I can't –

GLAZEBROOK J:
It was never explained?

MR GALBRAITH QC:
Well I’ll check but I don’t immediately recall it.

GLAZEBROOK J:
But it certainly doesn’t sound as though the SESS machine was fully functional. It might’ve been functioning but unless that’s what's referred to with the solution dyed nylon issue but is Mr Weston going to deal with it?

MR GALBRAITH QC:
Yes because the machine could, depending on setup, it could do either fibre or it could do – sorry it could do synthetic fibre or it could do wool. So I’m just not sure what the answer to that is.

GLAZEBROOK J:
Is Mr Weston going to deal with that a bit?

MR GALBRAITH QC:
Yes definitely, I’m sure he will.

ARNOLD J:

Now can I just, now that we've interrupted you.

MR GALBRAITH QC:

No that's quite all right.

ARNOLD J:

The passage you've just read which is on 9813 up the top of the page there and you get the confirmation that the company may not meet the sales forecast, the indicated amount not materially adverse as the forecast EBITDA number should still be achieved. It was noted the offer document focused on the forecast EBITDA results rather than forecast sales which is right of course, it does but if a drop in forecast sales was material, just accept that for the moment, there would be an obligation to disclose wouldn't there? You can say that because the prospectus focuses on EBITDA.

MR GALBRAITH QC:

No, you're quite right Sir except that what one would say is and this is the point of course about the margin issue, that you need a pretty big drop in sales revenue to have a material drop in EBITDA. So EBITDA being, as they say a driving line item, along with profit and of course it's the same for profit, if you've got good margin you need a big drop in sales. Those are the two real driving line items and I can't give evidence from the bar but one might say that people tend to look at profit and of course all of the things about PE and that were all about, the PE multiples in the prospectus were all about multiples of profit or EBITDA but you're quite right Sir, I mean if the bottom had dropped out of the sales revenue inevitably there'd be a drop in the EBITDA and the net profit and it would be material then.

GLAZEBROOK J:

I was just going to say if the drop in the sales data was the starting of a different trend or possibly the start of a different trend, rather than a one-off blip you do accept that would be relevant as well I think.

MR GALBRAITH QC:

If you knew that, if that was the judgment you made.

GLAZEBROOK J:

Well if you knew that.

MR GALBRAITH QC:

Well if you didn't know that you wouldn't know it was a one-off blip or you'd have to make a judgement call on that and if you're still –

GLAZEBROOK J:

Well is it for the directors to make a judgement call would be the question on that if you don't know or is it for the market to make a call when it's disclosed because one would if you were just doing a prospectus afresh disclose this information?

MR GALBRAITH QC:

Well that's what the Court of Appeal of course said that if you were doing the forecast in June when you knew this, yes, you'd adjust your number, yes of course you'd do that but it was a forecast which made at a certain time which the prospectus expressly said wasn't intended to be updated or changed.

ARNOLD J:

That can't be here nor there, can it? You can't say I'm not going to update this if there's a material change, you've got an obligation to amend.

MR GALBRAITH QC:

If it's materially adverse because the statue says that.

ARNOLD J:

Yes, adverse.

MR GALBRAITH QC:

So no disagreement with that at all Sir. Yes, you have to say well the world has got worse or our results have got worse or whatever it might be if you

decide it's materially adverse but you've got to make that judgement, is it materially adverse or not and so it is for the directors to make that judgement and they do it, and what I've been labouring, is that they do it in the full context of everything they know at the time and also what they can project at the time, so what they're being told about, as I say, the future performance, the section which is in here and which Sam Magill is talking about here, "We things are going to be good next month in June," of course they were and he was right.

GLAZEBROOK J:

I'm not entirely sure that, I mean it might be saying the same thing, I don't think it's the directors – obviously the directors have to make that judgement because they have to decide whether to disclose and if they make it, the due diligence defence might, if they make it but on reasonable grounds the due diligence defence might come in but it has to be an objective test, doesn't it?

MR GALBRAITH QC:

Yes, no, I agree entirely Your Honour. All I was really trying to say was when somebody sits around the board table on the 2nd of June somebody has got to make the decision one way or the other but I'm not suggesting that that's – no it's got to be objective.

ELIAS CJ:

And if its objective, if they get it wrong they only have a defence if they can bring themselves within the due –

MR GALBRAITH QC:

That's right, that's absolutely right, and then the minutes go on to record what Mr Tolan said. He confirmed that the working capital and debt level cash flows were all in line and you will recall in the prospectus it has got cash flow projections, et cetera. CAPEX likely to be less, the only number in the forecast may not be achieved so a sales number should not be in issue because any of the other forecast amounts. Des confirmed the company's balance sheet should be in line with the forecast balance sheet. Des

indicated that sales shortfall would be between 7.5 and nine million, approximately 2.8 per cent. Sales for the fourth quarter were currently down around 10 per cent but the feedback from the market indicates that June will be a strong month as the retailers push for their quarterly rebates confirmed that in his view he did not consider the company not meeting its sales forecast was a material adverse circumstance as the company should still achieve EBITDA and net profit after tax forecast numbers.

And then on the next page questions are recorded that the committee asked the management. So production issues, you'll see that production issue about the solution dyed nylon issue which was the three million. Have they been revolved? It was confirmed that the solution dyed nylon issues that affected production April/May have been resolved. The company has changed the product, undertaken trials, the yarn is now in usable form. There are some commercial machine problems but all capacity issues are now being resolved.

Carpet Call was likely to be as forecast. They were in the middle of enterprise bargaining at the time. Woven, they were doing a restructure on the woven plant. Foreign exchange, companies cover and place for the Australian/US cross rate and for the NZ Australian cover with a rate close to forecast numbers. The forecast is a high level of competency EBITDA costs will be mid actual one-off costs including the forecast to anticipate to be below the forecast numbers. Projections to price increase should increase sales by approximately $8 million. The price increase should increase sales by approximately $8 million. The company strategy not to discount or continue, the revenue line should be protected. Price increase as a result of anticipated raw material increases in the new financial year which did come through from the US. Because synthetic product is effectively oil-based and so oil prices affect that.

Shaw Industries, that's of no significance. Forecast process, the Chief Financial Officer confirmed that the company’s process for developing the forecast and projections was robust and sound, he’s confirmed nothing would have been done differently in hindsight.

GLAZEBROOK J:

Apart from perhaps looking a calendar.

MR GALBRAITH QC:

Yes that's probably fair comment Your Honour. And then the chairman asked each member of the committee to confirm whether they were comfortable. All members, together with Ernst Young, First NZ Capital, Forsyth Barr confirmed they were and each confirmed there were no material adverse circumstances and then there was then a reporting to the Board for a Board meeting later that day and I'm not sure that I immediately have the Board minutes for that meeting. I'll find them. Because that was, and you'll recall my learned friend Ms Mills took you to Ms Withers' notebook of the directors meeting later that day and you can see the items which were being discussed and each of the directors gave evidence about that meeting and as I said in that extract I've got under tab 12, Mr Saunders explained, stepping aside from what everybody else thought and what had been put in his draft brief et cetera, in his brief, summed up his views on that day on the issue of materiality and his confidence and comfort that they could go forward with the allotment.

Now we've said in paragraph 39, it's apparent I would say from the minutes, the factors which influenced the directors to that view, obviously the fact that the sales shortfall being less than three percent, that it was caused by one-off operational matters, that comfort was given that the synthetic nylon problem had been resolved which was worth three million of that drop, that June was to be a strong month, which of course it turned out to be and that the margin, they were going to protect the margin for which their profitability had been dependent upon or supported by and so that's the factual position which assessed objectively is, Your Honour is quite correct has to be. Both Courts below accepted that there was no – it was an appropriate decision that there was not a material adverse circumstance that prevented allotment proceeding or would've required withdrawal of the prospectus and an amended prospectus to be put out.

And then as we know, the results came in actually a little bit better than that because the shortfall was only 2.3 per cent and the EBITDA was met and so was the net profit after tax met and I don't think I need to take you to – we've got in our written submissions the evidence of the expert witnesses on that issue but I do I think need to deal with a couple of the other factual matters that have been raised by the appellants and I think the only two, apart from tufters which were outstanding at the moment is the MIP issue and the extended credit issue and we, as you know, have got an appendix to our submissions which deals in part with those and perhaps if we deal with MIP first which is at page 48 and MIP was the staff bonus issue and my learned friend took you to Ms Withers' cross-examination yesterday.

So what we say on page 48 is that there's a criticism by the appellant of the Court of Appeal's finding that the forecast figures and the prospectus included the underlying removal of bonuses for sales staff. 108 doesn't actually say that but what did happen was that because the performance of the – the business performance as against budget, didn't achieve the criteria which the bonuses were to be tied to, then the bonuses or part at least of the bonuses weren't paid for the June year. But I just take you, in that extra bundle I put in, can I just take you to a little bit of evidence on the subject. Behind tab 9 is some cross-examination of Mr Tolan.

O'REGAN J:
Is this in your new volume?

MR GALBRAITH QC:
That new bundle, yes Sir, sorry, just behind tab 9. There is some cross-examination of Mr Tolan and we put it in here because it's not in the common bundle. You will see around about line 14 just about half way down the page, "We got to EBITDA before MIP," answer, "Yes." Question, "What's that?" "MIP stands for management incentive programme." Question, "Has there been a budget for MIP for May 2004 of 244,000?" Answer, "Correct." "And forecast for?" "Correct." "The entire year 1.9 million, sorry, that's year to

date, sorry, year to date," we can perhaps forget about that. It totted up to about 2.3 I think for the whole year.

Go across the page, around about line 10, "It's 1985." "Yes I can see that." "If we go now to the next page which is the May, the actual May figures, month of May reversed out of the actual figure, the management incentive programme, haven't you?" "Correct, yes." "Was that one of the reversals that enabled you to meet your EBITDA projections?" "Well the management incentive programme was put in place where if we achieve certain objectives so just a monthly general accrual and based on our forecast at that stage we were not going to achieve those incentives so therefore they were reversed out." "But that was for all the previous months of that financial year?" "Correct." "So the management are not going to get their bonus for the months from July to May?" "Not months, it's an annual bonus, it's paid after the financial results for the full year have been determined, those targets are higher than outside the budgeting process so we have to achieve certain targets and we made an assessment in there, we said we weren't going to achieve those targets so we reversed out the provision the accrual provision." "Would that be one of the reasons why you were able to meet the EBITDA profit figures?" "It was part of the reason, yes." "That's reversed the 1.6-odd million?" "Correct, that's the general referral we had to make." "So were the incentives for making the sales for making the bottom line as I have said to you a number of times in the session it's what generates valuation. Business valuation is profitability so management are never incentivised on sales we were incentivised on profitability but the targets aren't reflected in here, the targets have a separation target." And then there is some cross-examination about reduced costs which I don't think is relevant.

Across the page at 3946 which is a later passage of cross-examination. Do you see about line 14, "See the bullet point, no MIP has been provided in the current financial year as the MIP threshold has not been achieved. This is the EBITDA diary of reconciliation prior year actual to current year actual and NZ dollars external reporting basis?" "Yep." "So you accept that one of the steps you took, that Feltex took to achieve its EBITDA figures is to reverse out the

MIP?" "Let's clear down to what MIP is. It's a management incentive programme which is totally discretionary based on certain achievement of certain targets so it wasn't a fixed payment we made it was purely a provision we provided every month. The assessment only takes place at the end of the financial year whether we achieved those. Now those targets, I don't recall exactly what the targets were but they could have been different to what the projection was." "So you'd accept that MIP was included in your calculations, projection and forecast and there was a MIP figure built in there but more as a number, it wasn't tied to the actual plan as such, it was just a provision provided for, it's a provision that came to 31 December 2004," and that's where that stops.

So it's entirely consistent with the Court of Appeal and the High Court's finding that it wasn't a commitment and it wasn't provided as a commitment but simply as an accrual in the monthly accounting along the way and it was an annual construct and they'd hadn't met the, they weren't going to met the threshold and you will see under tab 10 we've simply included that page of Ms Withers' cross-examination that we talked about yesterday. And the only reason I have included it under tab 11, the minutes of a Board meeting of directors on the 27th of July is that if one goes to the third page of those minutes. You will remember yesterday my learned friend said, well, what they did they reversed that 1.6 million, it looks as if, I mean I think in accounting terms that's correct but it looks as if you will see item 513, "MIP a provision of 700,000 of MIP has been included in the financial result for the year ended 30 June 2004. The allocation and payment will be put forward to the Board's remuneration committee, so it was a consideration by the directors as to whether and what bonuses should be paid and a decision was made that obviously some bonuses should be paid and that was a post-2 June decision because that's a decision made in latish July. So the short point of all that is it wasn't a cost cutting measure that was undertaken to struggle to get to EBITDA, it simply hadn't been earned but was reconsidered obviously subsequent to 2 June and allowance in part made for staff bonuses and –

ARNOLD J:

Why would you take it out partway through the year?

MR GALBRAITH QC:

Simply, well Mr Tolan's explanation was that it wasn't going to be achieved, so it was simply an accrual item. It only went out – I mean you still find it in that June end of year trading results that we looked at before. And what it had and I don't think it got this, but after that, what are they called, that one-pager that you were taken to, the next page usually had EBITDA without MIP, EBITDA with MIP, so it had the two possibilities and whatever the variances were in it and that was their month by month but nobody was committed to paying it unless of course the criteria had been met, in which case there would've had to have been a payment obviously. So in my respectful submission MIP doesn't, well it would be an odd thing to require a separate disclosure of, it's just part of businesses as usual. Extended credit terms, we go on the same page, that's page 48, to talk about those.

GLAZEBROOK J:

Am I right, if you said it was still in that data that they would've been considering the position assuming it was payable when they were looking at it on 2 June?

MR GALBRAITH QC:

MIP certainly didn't come up on 2 June as anything they were considering.

GLAZEBROOK J:

Well no because they were just considering on the accounts that they had which you said included MIP.

MR GALBRAITH QC:

Yes it would've because they would've had the April accounts.

GLAZEBROOK J:
So they wouldn't known that they were going to achieve the EBITDA at that stage presumably. They were counting on much higher June sales I think.

MR GALBRAITH QC:
Yes they were counting on much higher June sales but MIP wasn't tied to, well –

GLAZEBROOK J:
No, I don't personally think there's anything odd about this, it's just that the fact that they reversed it later I'm not sure suggests anything one way or the other.

MR GALBRAITH QC:
No.

GLAZEBROOK J:
And especially if when they were looking at it, it wasn't reversed out.

MR GALBRAITH QC:
No not at that stage. Certainly the April trading results they had still had MIP in and it was reversed out, at least on the evidence, just because it wasn't payable but they then, and you can understand directors saying well take all the bonus off the staff, they're not going to be happy with that, so we'll pay them a proportion of it, which is the 700,000 in July which was recommended to be allocated.

GLAZEBROOK J:
Well they had less 700,000 was my understand anyway hadn't they or is that not clear?

MR GALBRAITH QC:
I don't know when that reversal, I'm sorry I just don't know when that reversal was done.

ELIAS CJ:

So we don't know when the reversal was done?

MR GALBRAITH QC:

I don't, no.

ELIAS CJ:

It seems odd after three months.

MR GALBRAITH QC:

I had a better memory in those days Your Honour. So extended credit terms, as we say in paragraph 17, page 48, the High Court judgment does note that those allegations evolved through the amended statements of claim and were also refined during trial. I think we've come to a slightly other refinement now. Very much in the High Court at least, it's set out as being an issue about forward dating of invoices and in fact before the High Court and the Court of Appeal at one stage it was suggested it was akin to fraud, was one of the submissions that was made at that time. In any case reality came to the rescue over time and it was recognised on the evidence that it was simply a, I shouldn't say simply, it was a way of allowing an extended period of credit for customers who bought late in the month who would otherwise be paying on the 20th of the following month and so if the sale was on say the 28th of the month, if it was invoiced as the 1st of the next month, then they got through to the 20th of the month after that month.

ARNOLD J:

What on earth was the explanation for it? I mean why not just give people –

MR GALBRAITH QC:

The explanation, the principal explanation for it was that it was to encourage people to purchase early or put their orders in early in the month, so they didn't suddenly get a huge backlog at the latter end of the month. I think I'm right in saying that was the explanation. It was a practice that had been in

Shaws for years and it was brought over into Feltex when Feltex took over Shaws.

GLAZEBROOK J:

When did they book the sales?

MR GALBRAITH QC:

They booked the sales when the carpet left the factory and that was all audit ticked, enquired into and I think Professor Newberry at the end of the day accepted that was appropriate.

GLAZEBROOK J:

And perhaps when did the, in terms of these forward invoices, what was the relationship between leaving the factory and when they put the invoices out?

MR GALBRAITH QC:

The relationship, well it obviously depended when the carpet left the factory but if it left the factory on say the 28th of the month, the invoice might be the 1st or 2nd of the following month.

GLAZEBROOK J:

So they effectively booked them when the sale was effectively done.

MR GALBRAITH QC:

Yes, yes.

GLAZEBROOK J:

I.e. when they delivered the goods?

MR GALBRAITH QC:

That's right.

GLAZEBROOK J:

And that was likely to be before the invoice was actually, well at least before the date of the invoice if even if not before the invoice?

MR GALBRAITH QC:

Yes.

KÓS J:

That's not unusual but did they alter the date of the invoice?

MR GALBRAITH QC:

No.

KÓS J:

I mean what did a forward invoice look like?

MR GALBRAITH QC:

I don't know if we've got any in here. We've had dozens of them in Court.

KÓS J:

Well from memory, describe one.

MR GALBRAITH QC:

Well it looked like an ordinary invoice except that the date on it would be whatever date, the 2nd of June.

GLAZEBROOK J:

So somebody would order it, you'd send the goods out on the 25th of March and then later or at the same time would send an invoice out dated the 1st of April or the 2nd of April, something like that?

MR GALBRAITH QC:

Yes. There'd be a delivery docket with the goods obviously.

GLAZEBROOK J:

So it probably would've been fraud if you'd sent the carpet out and then pretended to bring it to book on a different financial year but you're actually doing it in accordance of when the sale was definitively done, ie when the carpet left the factory.

MR GALBRAITH QC:

And there was on occasions, and only on occasions, there were situations with commercial sales where the carpet was ready to go but the building say wasn't ready to receive the carpet and so provided it was acknowledged by the purchaser, they stored the carpet in the meantime but booked the sale because they had the carpet sitting there and they've stored it and then it's not going to go out till when they'd finally finished the painting on the building. So there were examples of that also. So we went through in great tedious details, as I say, lots and lots of these invoices and the whole practice and I think I fairly summed it up by saying at the end of the day, well what do we say here, in our arguments about the data and that but I don't think at the end of the day there was any issue about the legality of what they did but the issue was a concern by the appellants that by encouraging sales to come forward in effect rather than getting a sale on the 1st of July, if you're the purchaser you may as well get your carpet on the 28th of June because you're not going to get penalised by doing that because you're only going to get invoiced on the 1st of July that you might be cannibalising your July sales if I use that expression. And as we say in paragraph 20, it's not a like for like because this, as he says there, "The reality of some of the sales under extended credit terms would have been made in the same month in any event, in other words the customer took the benefit of the extended credit on offer but would have purchased the carpet in the earlier time in any event and other sales would have been made by our competitor had Feltex not offered extended credit to attract the customers to buy from it." So it was part of their marketing approach.

But that's not, I don't think, the extended credit which is now being focused on though that was a huge focus in the High Court. As I say, we spent some days on the subject . As I understand the extended credit argument now it is that on that 8 April presentation that was made to the directors there is a reference to extended credit to grow sales and perhaps we need to look at the 8 April which you've got in that bundle which I haven't got but I will find the 8th of April. Document 307.

GLAZEBROOK J:

Sorry, what document?

MR GALBRAITH QC:

It's T307 and it's in that bundle which my learned friend handed up this morning.

GLAZEBROOK J:

Sorry again, I just haven't found it.

MR GALBRAITH QC:

8933 is the first page I think, sorry, 8933 isn't the first page of it. 8930 is the first page of it.

ARNOLD J:

It's not in there.

GLAZEBROOK J:

No.

KÓS J:

It's volume 3 of the consolidated bundle.

MR GALBRAITH QC:

Yes, it's volume 3 of that bundle but it should be 8930.

GLAZEBROOK J:

8930?

MR GALBRAITH QC:

8930.

KÓS J:

Yes.

MR GALBRAITH QC:

And the page which is relevant to this argument, as I understand the appellant's argument, is 8941.

ELIAS CJ:

Strategy?

MR GALBRAITH QC:

Yes, and so there is as comparison between the then and the now and under the now you'll see, well it's probably worth just having a quick glance at it, but the focus is the last bullet point under "now" as I understand it, "To reinforce the growth strategy and to encourage the movement of business from our competitors we will offer extended terms for the sales growth," and what is said, as I understand it, is that the extended terms referred to here are different from, different in kind or extent from the forward dated sales which I was talking about a moment ago and which we spent most of our time on in the High Court, and different, I think different from the roll offer sales which and what they were, were there's your summer rolls programme, et cetera, Feltex tried to sell literally rolls of carpet to retailers or wholesalers on an extended credit basis and the obvious point of all that was that retailers and the wholesalers preferred to have the smallest volume they need to pass onto their customers but this was an attraction to move bulk and the proposition, as I understand it, is that the fact it was intended to give extended terms to reinforce this growth strategy, I think the proposition, or I think the high point of the proposition is that that was something that should have been stated in the prospectus and perhaps if I say the low point, I don't mean that in a pejorative sense but the low point of the submission I think is that it's something that you should take into account in considering the sales revenue shortfall because extended credit may have an impact on your financial position which I don't agree with but that's as I understand the argument. So as we rightly said and as the High Court rightly said, this is a topic which has moved more than once in the course of the three hearings that we've had.

So you'll see in our paragraph 23 and we say in the submission, the intention to increase credit terms have not disclosed the prospectus therefore breaching this regulation. Of course the regulations weren't previously a part of the arguments we faced. So I guess again it comes back to a materiality type issue. Now what we say in 24 is that this wasn't an issue pursued in the Court of Appeal and shouldn't be pursued in this appeal but dealing with it on its merits, I've included two extracts in that small bundle I handed up this morning. The first again under tab 7 is cross-examination of Mr Tolan and you can see on the first page under tab 7 which is 3877, so down towards the bottom, last question, "And you're talking about increasing rebates to generate growth in sales?" Answer, "Well rebates is one of the tools that you, where you can encourage sales. You know, basically if people, customers reach certain volume targets, it's common to offer them rebates. It's an incentive to them to achieve a certain sales level, very common right through the industry. So when did you increase your rebates to generate growth in sales? There was no specific date, it was basically targeting programmes to say to customers well, you know, if you get this is your expenditure this year, the volume this year, if you do this well you get to the next rebate. There was no specific date, it was reviewed on a regular basis. So were you asked by anyone at this presentation what the actual proposal was for the increase in rebates to generate growth in sales?" Answer, "I can't recall specifically."

ELIAS CJ:

What presentation is he talking about?

MR GALBRAITH QC:

That's the 8 April presentation. "So did you have any figures to support that? Well this presentation was supported by a very comprehensive forecasting model. And that's the one that was done of 1st April? No the model wasn't done on the 1st of April, the model was built up over a period of time, probably February, March into April. What was on the 1st of April was a presentation to the Board. And then you're going to focus on reducing skews and yarns and carpet skews?" and he was saying, "Yes we are going to do that, reduce them back to the profitable ones." They had some hundreds of individual yarns and

carpet skews and part of the programme was to reduce that number and then line 24, “And then to reinforce the growth strategy and to encourage the movement of business for our competitors we will offer extended terms of sales growth?” Answer, “Yes.” “These summer and winter rolls that you’ve talked about before?” Answer, “That was part of the programme but it was more of a generic reference to rebates being one of the things that stimulates sales, payment term is another one. So what were these extended terms that were offered? There were no, we hadn’t identified exactly in the presentation those extended terms but there would be various extended term programmes put in place to encourage sales. When you made this presentation had you done any analysis on the effect of extended credit terms on the company’s cash flow for example? Well every time we did a programme on extended terms we looked at the cash flow impact of that, we had a comprehensive cash flow forecasting programme at Feltex where you can see there I had a specific person reporting to me who managed treasury and one of his roles was actually managing cash flow, not only daily but weekly and monthly. Yes but did you produce, present anything at this presentation about the effect of extended terms of the sales? Not at this presentation no but the management team understood the impact of those, that initiative. If we go to the next…” and then talking about the upside and downside. So I don’t think there's anything more there but if we go across to page 3952.

ELIAS CJ:

And there's nothing in the – so is that the Board, this is the presentation of the Board?

MR GALBRAITH QC:

Yes the 8 April.

ELIAS CJ:

The 8 April.

MR GALBRAITH QC:

Yes.

ELIAS CJ:

And there's nothing in the minutes about this discussion.

MR GALBRAITH QC:

No it wasn't a Board meeting, it was a due diligence committee meeting that some of the Board members attended.

ELIAS CJ:

Oh yes, yes, some of the Board members right.

MR GALBRAITH QC:

And then the cross-examination is picked up again on 3952 which is the next page over.

ELIAS CJ:

So where was the decision being taken then about extended credit terms?

MR GALBRAITH QC:

Well extended credit is basically a management decision I think one would find.

ELIAS CJ:

It was just a presentation about what management as doing?

MR GALBRAITH QC:

Yes.

ELIAS CJ:

I see, it wasn't a decision, yes.

MR GALBRAITH QC:

And you will see when you come across to 3952 in cross-examination around about line 12 or 13, "Now I've been speaking about Professor Newberry's evidence the issue of forward dating invoices. I think by the time Professor Newberry's final brief was given there was consents between you

and Professor Newberry that forward dating invoices occurred, that's correct?" Answer, "Well the term 'forward dating' was used in terms of certain invoices, yes, and that terms is used, was synonymous also with extended credit terms. Well by dating the invoice the first of the month it allowed us to facilitate the extended terms for the last few days of the month, the last 10 days of the month. "And Professor Newberry has accepted your evidence that the carpet was dispatched is at the date the invoice was generated, hasn't she?" Well the fundamental principle always was the carpet was despatched, it was the despatch of the carpet that triggered the invoice and that would apply to any of your extended credit sales as well, it applied to all sales," "And that the terms were basically synonymous with," sorry and the question was, "And that the terms were basically synonymous within Feltex. When you refer to an extended credit sale it was also, could also be referred to as a forward dated sale?" Answer, "Well forward dating was a means of actually providing the regular the last week of the month the extended terms of those sales so it's a common term used in Feltex, yes." "So in the statements that went out to retailers the bottom box of those statements would have a division between current, past due and forward dated. I don't think it referred to forward dated I think its referred to not due." "Perhaps we could have a look…" and then if we, I think that's all probably which we need to look at there.

But what you will see there is that Mr Tolan and, with great respect, my learned friend then, though not now, was accepting that forward dating and summer and winter rolls and extended credit were all part of, effectively, extended credit, that's various ways of extending the payment terms of the sales and was put to Mr Tolan at the foot of 3952 that the terms are basically synonymous within Feltex.

So you've got what is business as usual and rather odd proposition that one should, there's some omission from the prospectus to not state that, and I've included there also under the next tab, tab 8, I'm sorry I didn't put a name on it but it's cross-examination of Mr Horrocks and what the appellant was seeking to identify there, and correctly, was that receivables were up at around about $10 million round figure by the end of June and there's also some evidence in

cross-examination of Ms Withers where she said she's used to the media world where you get a bigger percentage of payment each month because that's the way it is and there evidence was in this world you didn't get that same percentage of payment so you carried some receivables forward but as she said, and Mr Horrocks went on to say, it's the collectability which is the issue, you've got to make sure that you're going to get collected but it doesn't much matter, particularly when you've got a rolling business, it doesn't much matter that your receivables are rolled out for a month as long as you're going to get paid.

So there was this cross-examination in any case of Mr Horrocks and so if you look about line 10 it's put to him that the implied extended credit figure or the receivables is $10 million-odd dollars and he says it could be, I'm standing here now, I don't know the answer to that, and the question at 16, "So I'm suggesting that extended credit made up a significant amount of your accounts receivable at 30 June commensurate with strategies put in place to achieve the forecast period, that's correct isn't it?" He said, "Are you saying by implication that this is a different strategy?" Question, "We've identified Mr Tolan's strategies put forward in the 8 April presentation was to offer extended credit terms to achieve growth and sales, haven't we?" Answer, "Yes." Identified as best we can because we don't have a report as to how much that June figure was, a significant amount of extended credit at 30 June?" Answer, "I'm unable to make a sensible answer on that, all I would be concerned about which is illustrated by the audit and risk management committee meeting minutes are we had a forecast in relation to a forecast statement in relation to the current assets. We had a process which was well managed, these were part of day-to-day life at Feltex whether it was rebates or financing. They went up and down." I clearly in the audit and risk management committee meeting highlighted the issue but whether it was material at the end would have been the issue and I have no recollection of any issue raised by the auditors as to materiality of this. This was ordinary business of Feltex. The numbers that I would have focused on would've been the fact that we had provided a forecast. Yes we had a trading pattern and I would have been always concerned and that was the point of my enquiry. If

the normal operation of the business had gone outside any of the parameters that we set including the forecast. But you've noted that there's been an extension in credit terms but there's no analysis to what effect of these extended terms in these papers? No. I was comfortable with that, that's not what we were managing. And nowhere in the prospectus is there any indication that Feltex was offering an extension to credit terms as a means of meeting their forecasted projection, not one of the assumptions is it? I do recall that this was discussed. As far as the forecast period went the variable that we were managing was the working capital of the company which was covered in a specific part of the forecast but in terms of projections I believe that that was specifically mentioned."

If I can just take time to have a look. So he's taken then to the assumptions and risk in relation to forecast and then at the bottom of the page, "Yes I'm referring to my recollection was that this, the forecast was dealt with by way of a forecast with a balance sheet only, so the working capital assumptions there were set out with the rigor that's required for the forecast. The greater concern was going forward and particularly with the new tufters. On page 92 the working capital, we're talking about working capital here and it comes back to this issue of the inter-relationship between increasing stock keeping units with new product. It says here working capital is assumed to be consistent with sales projections and the historical working capital requirements of the business with a small increase in inventory associated with the introduction of new products during the projected period and the introduction of some varied payment terms associated with sales group assumptions. Now so I do believe it was addressed in the prospectus at least at that point. Without going further I do believe that that issue was dealt with in terms of all the tests in relation to materiality. So where is that in relation to the forecast period? Well as I've said the forecast provided a balance sheet, projected balance sheet showing the projected working capital which is on page 87. I don't think that was specifically noted in the forecast in the same way. It was noted in the projection because it might have been material given the introduction of new technology in the form of the tufters and the likelihood of having that lag and run up to being in a stock position with both samples

and sufficient inventory to be able to supply the distribution chain and obviously when a new product like that was introduced, the market expectation was that the retailers would be given some sort of incentive, whether it was a rebate or financing to assist them into our new stock position but the offering of extended credit also has an effect on revenue doesn't it because one of the strategies put in place to increase your revenue et cetera? We've always offered extended revenue, it was business as usual and the revenue assumptions quite clearly say it's business as usual, so we, the customers, would continue to trade with Feltex at the current levels. It was business as usual." And then talks about the increasing practice of forward dating and sales.

It goes on to say about line 9, "We did have a programme we were running through this period resulting in extended credit, it doesn't in any way concern as to materiality because the key issue I was concerned with was the working capital. These were the tools that the company used just as its competitors used. Two issues, the question of working capital, the question of revenue, something should have been disclosed in the prospectus. My reply is I would expect management to use the tools that were available to it to provide the sales results that they did, so that deals with the revenue point. The other point which is a more serious point is if working capital got out of alignment which it did not." And that's the cross-examination.

So what he's talking about of course in relation to new product or new technology is that you've got samples and there's evidence about the cost of that and you've got to hold inventory and that changes your working capital and of course when you're trying to persuade retailers to stock your new product, they're going to have to have samples and they're going to have to have inventory, so you offer them an incentive because otherwise you don't make the sales. Now that as he said is simply business as usual which was the conclusion which the High Court and the Court of Appeal came to regarding the forward dating issue because often argued in this form and as I recall at least in the Court of Appeal and so my respectful submission is it is simply business as usual and it would be a most odd situation for a company

to say to the world at large, we're going to extend credit to our retailers and so your competitors can cheerfully go along and know what you're going to do. I mean it would be one of the most unusual things that one might foolishly do.

So those are those two, I think that wraps up the factual matters and we've got a section which I think is now redundant about the appellant's response to concurrent findings in the materiality because we had understood from the submissions that there were some specific suggestions made about the scope of the regulations and what could be put in the prospectus but that doesn't seem to be in pursuit so I will just leave that there in its written form because the regulation have now been, as I understood my learned friend's argument yesterday, being that point has been run in a different way now that either there is an omission and therefore an untrue statement because we haven't complied with the regulations, that's the unpleaded allegation if that is what is now being pursued, or there's the alternative that this information because it wasn't provided to the subscribers, or potential subscribers, it somehow affects the materiality of the failure or the over reporting in the prospectus of sales revenue.

So we had a section starting at paragraph 52, our challenge to the Court of Appeal's decision that there was an untrue statement. That submission of ours – you will recall in the High Court His Honour held that there wasn't an untrue statement. In the Court of Appeal a little bit for the reason that Her Honour Justice Glazebrook put to me, the Court of Appeal held that there was an untrue statement because if you were starting afresh on the 2nd of June knowing what you did and you were drafting up the forecast and the projection you would adjust it for the expected shortfall and obviously you would because when you do this you try and do it on the most update figures you've got. Our submission is that entirely subject to the materially adverse point which His Honour Justice Arnold put to me that in fact this was explicitly stated in the prospectus to be effectively – it was a forecast as at the date it was given, it was a forward looking forecast. It wasn't intended to be re-visted as a forward looking forecast and so as at the date of 2nd of June when the allotment was made it was still a correct forecast as at the date it

was made which was the 5th of May, nothing had changed in relation to that. It was a forecast with effectively a statement of opinion, forward looking opinion and of course a forecast has to be reasonably based and so there was nothing untrue about these –

ELIAS CJ:
Is that affected at all by the fact that the legislation or the schedule envisages forecasting?

MR GALBRAITH QC:
Yes it does and that's why we – because one of the arguments the appellants seem to put forward was that you couldn't have forward information other than that was specifically identified in the regulations. Well there were two things about that, one was that you do have to put in future prospects, your view of the future prospects. Once you do that you come under the accounting standards in respect of forward projections and so you've got to put in that sort of information and in any event the regulation isn't one which is exclusive in the sense of saying you can't put anything else in it's what you have to put in so –

ELIAS CJ:
No, what I meant was the emphasis you put on a forecast being a statement of opinion, you know, some of the old case law about the difference between opinions and facts and whether you can say that something is untruthful or not, I just wonder if it is affected by that scheme?

MR GALBRAITH QC:
Well the forecast, there are specific requirements for forecast as against projections and effectively the forecast has to be properly based on what the directors do intend to do and appropriately can do.

ELIAS CJ:
It has to be honest.

MR GALBRAITH QC:

It's got to be better than honest, well, yes, sorry, it's got to be honest definitely but it's got to have a – it can't be on assumptions in the same way that a projection can be because a projection you can assume because a projection often is further out. You end up assuming a state of affairs whereas a forecast has got to be based on, if I can put it this way, harder data, have a harder foundation and the decision was made here that they would forecast for the three month period but only project for the further 12 month period for that very reason and the prospectus spells out the assumptions which are made in relation to the projections. The assumptions were that the world stays flat, that the customers still deal with us, those sort of assumptions, but as we all know the world doesn't stay flat so unfortunately.

So the argument on the untrue statement only of course deals with the appellant's new submissions or the appellant's submissions in respect of the suggestion that it's that this information is relevant to assessing the materiality of the shortfall of revenue. If the Court is prepared to engage with the appellant's unpleaded claim that the regulations required this information to be provided and therefore there is an omission and therefore there is an untrue statement that's a different allegation altogether and that's not what the Court of Appeal is talking about, it's talking about the revenue shortfall, and so what we say in the revenue shortfall it's not, with respect, correct to say that it's an untrue statement because it was maintained on the 2nd of June, it's a statement that that was the forecast that was made at 5th of May, it was properly made as at that date and implicitly that there has been no material adverse circumstance between the 5th of May and the 2nd of June which renders it, it's got to be correct in terms of, or you can't allot in terms of the Securities Act. So it's not an untrue statement it's a true statement still of what was thought at the 5th of May or forecast the 5th of May but implicitly there's been no material adverse circumstance which is of course what the due diligence committee meeting on the 2nd of June was all about.

So we would say that there isn't an untrue statement about the revenue shortfall subject to this new argument about if its allowed about giving an

omission that requires to be made and therefore that's an untrue statement. So that's really what we say in summary through to 58 and I think I can turn then to liability and materiality reasonably quickly.

We are now talking about section 56, I've got to talk about section 33 of course, but the section 56 and this was the topic that was discussed with my learned friend, Mr Carruthers, about what does 56 mean when it says, “On the face of a registered prospectus which contains any untrue statement for the loss or damage they may have sustained by reason of such untrue statement,” and of course, as you know, the position of the appellants is that there doesn't have to be a causative connection between the untrue statement and the loss and damage, it's simply provided you've got an untrue statement then ergo –

ELIAS CJ:
Well they do accept that there’s got to be a causative link, it's just that it's a but for link.

MR GALBRAITH QC:
Yes, if you can – I'm not sure about that.

O’REGAN J:
I think they're saying you're automatically liable whether there is any link or not.

GLAZEBROOK J:
Well the causative link is but for the prospectus I wouldn't have been able to –

MR GALBRAITH QC:
That's right, that's right and I'm sorry well, yes, it depends where you – yes, that's right, so the link is to the prospectus.

GLAZEBROOK J:
The prospectus is there, it shouldn't have been there so ergo I've lost money.

MR GALBRAITH QC:

There's at least a prospectus and the prospectus has got an untrue statement in it and there doesn't have to be a specific link between that untrue statement and the loss there just has to be the fact there's an untrue statement, and I said to Your Honours before that would be somewhat surprising, perhaps just let's put it that way at the moment given the way the law looks at misstatements generally.

So what we say obviously is that there has to be a causal link between the actual statement and the loss and perhaps just one indication of it is when one looks at 56(3)(c) which is the due diligence defence, or the reasonable belief defence and it just seems to me very odd that, because that relates as you'll see to the person who's been charged or to whom liability is being sought believing the statement was true up to the time of the subscription for the security. It would be a very odd situation where you had this great battle going on about yes I believe that to be correct and no you didn't believe it to be correct, about something which actually didn't have any bearing on the loss at all. That would be a very strange battle that would be waging and of course in a sense it would give a free option to a subscriber or perhaps when one thinks about what happens now in the disclosure situation in some jurisdictions overseas where you get some bad news and so you start legal proceeding and spend months trying to go through and find one dropped H somewhere or other and then say well I'm entitled to all my money back or damages even though it doesn't actually bear on a loss.

ELIAS CJ:

But there'd be a de minimis issue.

MR GALBRAITH QC:

Well if you don't connect the –

ELIAS CJ:

I mean materiality as we discussed earlier, it's quite a broad concept.

MR GALBRAITH QC:
Oh yes, yes.

ELIAS CJ:
So there has to be some bearing on loss. It can't be a missed H. That's what I was responding to.

MR GALBRAITH QC:
No, no, I understand what you're saying. Well of course the appellants don't accept that, they say no materiality, it just doesn't come into it, ergo you've got to –

GLAZEBROOK J:
They say peripheral.

ARNOLD J:
No, no they did accept the sort of de minimis ones.

MR GALBRAITH QC:
Well it's always easy to accept that Sir because what does that mean. I mean de minimis is only a measure of materiality isn't it of some sort of other?

ARNOLD J:
Yes it just takes out very extreme and obvious –

MR GALBRAITH QC:
Well it takes out, as Her Honour quite rightly pointed out to me, it takes out the dropped H.

GLAZEBROOK J:
But that comes back to how we define materiality which is probably something you need to deal with.

MR GALBRAITH QC:

Well the materiality that we would say or we do say is relevant, is the materiality that Lord Halsbury identified not so long ago, it's the materiality of something which you look at objectively and it would be expected objectively to induce or to influence.

ELIAS CJ:

But do you need that, do you need that in every case now that we have a statutory regime? It's bit like the duty of care in leaky building cases against the Building Act, you don't need to establish special facts which set up the relationship anymore, you don't need to go through that full tortious analysis because there is consumer protection legislation which provides a framework.

MR GALBRAITH QC:

Well the legislation here still requires and has done for a great long time, that connection between the untrue statement and the loss and damage.

ELIAS CJ:

And the loss yes.

MR GALBRAITH QC:

Yes.

ELIAS CJ:

No I accept but you always have to have that even under the Building Act you have to have that.

MR GALBRAITH QC:

But that's not the appellant's case.

ELIAS CJ:

No I understand their case.

KÓS J:

I would have thought your better argument was that Mr Carruthers' interpretation writes out of the statute the words "by reason of such untrue statement." Because it seems to be a double articulation.

MR GALBRAITH QC:

Yes.

KÓS J:

And his approach simply means you don't need the second bit of it because it's an untrue prospectus, it shouldn't have been there and they would've invested on the faith of it.

MR GALBRAITH QC:

Yes.

KÓS J:

So the only person who misses out is the person who just plunged their money out without even bothering looking at the prospectus.

MR GALBRAITH QC:

Yes or knew the facts or whatever it might be.

ELIAS CJ:

But they'd have to establish a loss in this case, whereas there may be people who invest who don't have a loss. So there will have to be some proof of damage.

MR GALBRAITH QC:

But the damage has got to arise from the untrue statement.

ELIAS CJ:

Yes and the damage arises from the investment and if the investment lost there is damage arising as a result, that's the argument I think.

MR GALBRAITH QC:

Well I'm not sure if – well, no, the argument as I understand is what Justice Kós just put to me which is that if there is a prospectus that has got an untrue statement it's a breach of section 33 ergo we get all our money back, forget about 37A or any of those things, you don't need those you just go straight through 33. What we're saying, which in my respectful submission is what 56 is saying, is that you've got to connect – the mere fact a loss happened, the but for, just say loss happened because I happened to buy shares in Feltex and it fell over and there was an untrue statement there, that's not a sufficient causative connection, it's not the connection required by section 56.

ELIAS CJ:

So what do you say is the connection that a plaintiff would have to establish?

MR GALBRAITH QC:

The plaintiff would have to show just what the Court of Appeal said, one, that objectively whatever the untrue statement is it's such that it would objectively induce, persuade, influence or whatever word one likes to choose, a person to act.

ELIAS CJ:

There are two stages though, aren't there?

MR GALBRAITH QC:

Yes.

ELIAS CJ:

And I'm talking about the first stage and I wonder against the statutory scheme whether it's necessary to establish materiality once you have an investment made pursuant to a prospectus. Then there is the loss stage, causation of loss and that I think is slightly different but certainly in the High Court there seemed to be a doubling up of materiality.

MR GALBRAITH QC:

Well whether you double up or I think, Your Honour, I might be agreeing that at one level or the other materiality does come into it, well certainly that's our position.

ELIAS CJ:

Yes.

MR GALBRAITH QC:

And so you can't recover loss unless it is caused by reason of the untrue statement.

ELIAS CJ:

Yes, but under section 37A you can get your money back even if you've got no loss. You can't demonstrate that actually the investment was a lemon.

MR GALBRAITH QC:

Yes, well, yes.

ELIAS CJ:

It just gets reversed.

O'REGAN J:

Yes, but that's because you cancel the subscription, it's a cancellation of the contract.

ELIAS CJ:

I understand that but does –

MR GALBRAITH QC:

But 37A is not quite as simple as that because 37A is –

ELIAS CJ:

Sorry I need to turn to it.

MR GALBRAITH QC:

– they didn't receive an investment statement or at the time of allotment the investment statement is known by the issuer to be false and misleading in a material particular, so 37A isn't quite as easy as that.

GLAZEBROOK J:

I suppose I'm still myself a bit stuck on materiality in the sense that you're saying that it would induce you to enter into the contract. I'm just wondering whether it's quite as black and white as that. In a float obviously you either go in or you don't but if there is something that might say, "Well I would have gone in at 150 but I certainly wouldn't go in at 170 ergo I didn't go in," but in fact you would have gone it at a lower price and that seems to be still to be material.

MR GALBRAITH QC:

I don't disagree with Your Honour on that, no I don't disagree.

GLAZEBROOK J:

So it can be not only just induce you to enter into the contract but influence you to enter into that particular contract which it might be related to price or it might be because there's some particular investment that they haven't disclosed that you wouldn't have wanted to be associated with a company of that sort.

MR GALBRAITH QC:

It's not the make all of it so I agree with Your Honour on that. As I say 37A does, apart from where you don't actually get an investment statement which is a black and white situation, it does require it to be false and misleading and all these sections when you look at them they have all got materiality actually expressed in them, it's all a particular that's material or whatever. The only free float, if I can use that term, is section 55 which actually has got material in relation to subclause (2) but doesn't have material in relation to subclause (1).

ARNOLD J:

I think there's an explanation for that actually.

MR GALBRAITH QC:

Yes I agree.

ARNOLD J:

Well material that's used in two difference senses and "material to" often just means relevant but material also has the meaning of significant or important. So if you look at 55(a)(ii) of the omission of a particular which is relevant to the statement. I think that's all it means and the concept – and so in that sense it's no different from one. The concept of materiality comes up later.

MR GALBRAITH QC:

Well that was what I was going to suggest to Your Honour that if you interpret it that way then it is no different from one, it seems to me and so I tended to interpret it the other way that it means that it's got to be – the omission has got to be something which is of some significance, not just relevant.

ARNOLD J:

I mean that doesn't make sense to me when you look at section 58 because section 58 talks about distributing an untrue statement.

MR GALBRAITH QC:

Yes.

ARNOLD J:

And then subsection 2 gives you a defence, proves that the statement was immaterial.

MR GALBRAITH QC:

Now if the concept of untrue statement included a concept of materiality, it seems to me you would have to prove that as part of effectively the actus reas but here it's saying you do the untrue statement and so that must be is it

untrue or not, is it a matter of fact and then if you've got a defence that it's immaterial, you then raise it.

MR GALBRAITH QC:

Well I mean that must be correct Sir in the sense that the untruth is something which black and white, then it is obviously an untrue statement but it must misleading because if it's absolutely wrong, it's wrong, simple as that but then when you come to 56 it's still got to cause the loss. So if it is of the – so, you know, so if we take the, you know, do a public registered office role or something like that, that's an untrue statement but with great respect so what under 56, it can't possibly –

ARNOLD J:

I'm not arguing about that.

MR GALBRAITH QC:

I don't think you are disagreeing, yes.

ARNOLD J:

I'm simply saying that I think 55 is not an anomaly, it's perfectly sensible. If material to just means relevant and then you get to the issue well you look at 56 and at that point some concept of materiality comes into play, I don't think there's any dispute about that, it's just where you put the bar, is it de minimis or is it a bit higher, is it a but for approach or is it a more specific approach.

MR GALBRAITH QC:

Well yes I obviously agree that concept of materiality comes into play.

O'REGAN J:

But isn't section 58(2) just a reversal of the onus of proof, it says you the defendant have to prove immateriality instead of the prosecutor having to do it.

ARNOLD J:

Yes but you only get to that point if there's a finding that there's an untrue statement.

O'REGAN J:

Well the allegation is made against you and you have to prove that it's wrong, rather than the prosecution having to prove that it's right.

ARNOLD J:

Yes but you've got to have an untrue statement before the onus is placed on you.

O'REGAN J:

Well you've got an allegation of an untrue statement. The prosecution asserts that against you and you prove it's wrong.

ARNOLD J:

Well we won't have a dispute here but I don't agree with that.

ELIAS CJ:

I don't have section 58.

MR GALBRAITH QC:

I won't take sides.

GLAZEBROOK J:

Well you probably in a way don't particularly care where it comes in, you just say it does.

MR GALBRAITH QC:

Yes.

GLAZEBROOK J:

Even if it's right at the screaming last moment of loss.

MR GALBRAITH QC:

Yes.

GLAZEBROOK J:

Sorry I'm being facetious.

MR GALBRAITH QC:

No, no, that's fair Your Honour, I'm comfortable with that but I do suggest that, and it is interesting because the Court of Appeal went back and had a look at the changes that were made when *Derry v Peek* [1889] 14 App Cas 337 (HL) was no longer the test and you had to prove fraud et cetera and so they did some historical research into how the statute changed and obviously the words of our statute are not much different actually now from the original English legislation. And really that issue, I mean that issue of the interpretation of section 56 and where section 33 fits in is all part of that consideration of how you interpret the scheme of the Act starting at I suppose section 33 itself and those provisions, and we deal with this in paragraph 81, those provisions which do allow for either void allotments where there has been no prospectus, the *Hickman* situation where it was easy in those days to get confused about what was a security and not a security and that happened in *Hickman* so you've got a void allotment, the position under section 37A where you either haven't got an investment statement or you've made false statements in a material particular and, Your Honour, Her Honour is quite correct that you don't have to prove the loss or damage there, you simply can avoid within the prescribed period and so 56 covers, I agree, a wider potential circumstance but on the appellant's submission you wouldn't need one or the other, they're just both doing the same thing only in the appellant's submission you have an untrue statement, it's not connected to anything at all, it's in the prospectus and you get all your money back which, in my respectful submission, can't be right on the scheme of the Act, which is what we say in 89. So unless I can answer any other questions.

ELIAS CJ:

No that's great, thank you. And what sort of progress do you think we're making.

MR WESTON QC:

I'll probably be about 15 minutes tops unless tufters gets us all carried away which I'm really hoping it won't.

ELIAS CJ:

Not likely.

MR WESTON QC:

And then Mr Smith will follow me.

ELIAS CJ:

Right, Mr Smith?

MR SMITH:

Perhaps 45 minutes or thereabouts and then my friend Mr McLellan.

ELIAS CJ:

All right, thank you, we should complete all that tomorrow. Thank you, we'll take the adjournment now.

COURT ADJOURNS: 4.59 PM

COURT RESUMES ON THURSDAY 7 SEPTEMBER 2017 AT 10.00 AM

ELIAS CJ:

Mr Weston, before we call on you we have a few questions, Mr Galbraith, we'd like to put to you, well not so much questions but opportunities perhaps to comment a bit further. You did say that you would go back to the commentary to the management reports and you didn't.

MR GALBRAITH QC:

Yes Your Honour asked me that and I did. Those commentaries, the important thing to notice about them is what I said quite early on yesterday that you were taken to the April and the May commentaries and the April one of course, I think we've accepted was available before the 2nd of June but the May one wasn't available until after the relevant time.

ELIAS CJ:

Yes although what do you take from that because I thought we had got to the point that under the legislation if material error in the prospectus is shown, then that may be extremely important in terms of the defence but it doesn't necessarily meet the potential liability.

MR GALBRAITH QC:

Now Your Honour is quite correct that there's a fact matter and that there's a knowledge matter and they're linked of course in the sense the judgment which has to be made in relation to what should or shouldn't – what is properly excluded from the prospectus is a matter which is borne upon by the knowledge which exists at the time. So you've got to put it into a context to assess that. What else one needs to say and you'll recall yesterday I took you to the 27 April minutes which show that the group operating report that was in fact in front of the directors at the date of 5 May was the one which referred to the March group operating report and it had a similar page but of course because March was a very good month it said all positive things. It's wrong to say all positive things because of course when you're selling a range of products you have some good news and some not such good news always.

So there was a similar commentary page in the March group operating report. I'm not sure if it's necessarily in –

ELIAS CJ:
I don't know that I have seen that one, no.

MR GALBRAITH QC:
I don't think it will be in the consolidated bundle, it may be in the case on appeal. I can have a quick look. Sorry but going back to the point that Your Honour is making to me –

ELIAS CJ:
I do think we have it at 6712 in volume 3. That's the group operating report for the month of March and the commentary is at 6712.

MR GALBRAITH QC:
Right. I haven't got there but Your Honour I'm certain that what it would say is some positive things.

ELIAS CJ:
Yes.

GLAZEBROOK J:
It says it exceeded budget by 1.4 per cent and total carpet volume exceeded budget by two percent after lower than expected orders over January and February. Does that sound right?

MR GALBRAITH QC:
Yes that sounds right and that's again budget which as you know on volume was evens but on dollars was higher by 20 million over the 12 month period. So that was a good result in March which is what they had at the end of April and then the next commentary which is the April commentary of course was much more patchy but of course they'd been warned on the 27th of April that April was expected to be a –

GLAZEBROOK J:

Sorry what were you saying was up over budget?

MR GALBRAITH QC:

What you just read to me Your Honour that it was one percent over budget, did you read to me?

GLAZEBROOK J:

Yes, you said it was much higher than that.

MR GALBRAITH QC:

No all I'm saying is the budget was higher.

GLAZEBROOK J:

That's right sorry, it's just the numbers didn't seem to be –

MR GALBRAITH QC:

No I'm not quarrelling with the numbers, just that evidence we had on where the budget sat as against –

GLAZEBROOK J:

Yes that's fine.

MR GALBRAITH QC:

But going back to the point.

ELIAS CJ:

I'd quite like you to comment on the commentary at 6389 and in respect of May 1 at 6894 in terms of the picture that is painted there because for example the April one, it's quite striking, the extent of the offset that comes from budgeted sales of seconds and aged stock, premium is 15.6 per cent below budget, everything is really down but it doesn't paint a picture of higher value being achieved.

GLAZEBROOK J:

Because if you look actually it says premium had lower average selling prices compared to budget, rather than it having higher margins if you look at the fourth bullet point down. Mr Galbraith I'm sort of particularly interested, I have to say, in what was the reason for these dips because there seemed to be a variety of reasons given. I understand that Mr Weston will be dealing with the tufters issue and so I don't expect you to comment on tufters as I understand you don't wish to and I can understand that, but Mr Weston will deal with that, but in terms of the other explanations given there seem to be a wide variety of explanations given some of which are not right, that is, exchange difficulties as I understand it but that's what I would be particularly interested in your comment on.

MR GALBRAITH QC:

Yes, well this one pager that you see here.

ELIAS CJ:

Well it's a two-pager really because the next page says, "Redbook and Minster Australia the month was a disaster."

MR GALBRAITH QC:

Hang on. Yes, what I was going to say was just what Your Honour is pointing to is that this one-pager had after it a whole series of reports in relation to each category of carpet and each, in particular, market.

ELIAS CJ:

Are these the ones we've got, the statements that we've got attached or were there more?

MR GALBRAITH QC:

I'm just not sure how much you've got.

GLAZEBROOK J:

Do we have the whole thing in the case on appeal because I think – we don't?

MR GALBRAITH QC:

No, I think –

GLAZEBROOK J:

I'm sorry, I meant in the one that we – because what I understand has happened here is that we've got just extracts from things.

MR GALBRAITH QC:

Right.

GLAZEBROOK J:

If we've got the full one in the case on appeal then we can look at anything that you refer us to.

MR GALBRAITH QC:

Well hopefully you have got the full one.

GLAZEBROOK J:

We do.

MR GALBRAITH QC:

And it was something like an 80 page document so it reports in –

GLAZEBROOK J:

Well this is the executive summary presumably.

MR GALBRAITH QC:

I suppose, in a sense.

GLAZEBROOK J:

Is that how we'd see it?

MR GALBRAITH QC:

Yes, and if you look at the last bullet point on that first page 6389 you'll see carpet margin percentage exceeded budget by 6.2 per cent due to a lower

cost mix available operating variance is offset by higher than budgeted sales of seconds and aged stock. In other words if you're selling seconds and aged stock it's going to pull your margin down because –

GLAZEBROOK J:

Do we know what margin they're talking about because we seem to have been talking about two different margins, one just mere sales less cost of sales.

MR GALBRAITH QC:

It's the budget margin they're comparing with.

GLAZEBROOK J:

Well I understand that but what is the budget margin you say, sales less cost to sales, or sales less cost to sales plus share of overhead.

MR GALBRAITH QC:

No, sales less cost of sales.

GLAZEBROOK J:

Sales less cost of sales, right.

MR GALBRAITH QC:

Yes, it was the one we saw in those –

GLAZEBROOK J:

No I'm just double checking what.

MR GALBRAITH QC:

So when you're selling seconds and that sort of thing it obviously pulls your margin down but they still exceeded their budgeted margin by 6.2 per cent.

GLAZEBROOK J:

Well it might actually increase your margin because you might have them in the books at nothing.

MR GALBRAITH QC:

Well you might, I can't answer that.

GLAZEBROOK J:

Because you may well have had to write them down.

MR GALBRAITH QC:

Except they've reported that it's the opposite that they have in fact actually reduced the margin.

GLAZEBROOK J:

No, it's a lower cost mix. They don't say its higher margins because you've got higher sales prices, they say it's a lower cost mix which does suggest they might have written down, as they probably should do, the seconds and things that –

MR GALBRAITH QC:

Well they say it's offset by hard and budgeted sales of seconds and aged stock which I think suggests that those sales pull down the margin.

GLAZEBROOK J:

Well I would have thought they might have pulled up the margin because you've got a lower cost base for those seconds. We can look at the report and see what it says.

MR GALBRAITH QC:

I'm not sure that it will break down to that detail but you see that the overall residential margin was 39.7 against the budget of 31.1 so it's in fact a significant increase on the budgeted margin.

GLAZEBROOK J:

But sales less cost of sales, it depends on your cost and your selling price.

MR GALBRAITH QC:

Of course, but that's what margin is.

GLAZEBROOK J:

If your cost is nothing because it's already written down on the second-hand then your margin is going to be huge even if your selling price is down. That's the problem with these sort of percentages and figures, isn't it?

MR GALBRAITH QC:

Well, yes, except I don't know that that's the fact, Your Honour, and that that would have been an –

GLAZEBROOK J:

But it certainly isn't sales of premium ones.

MR GALBRAITH QC:

– interesting thing to have explored in the three months we were there but it wasn't explored by the appellants.

GLAZEBROOK J:

Well you've made the three month point many times and it doesn't get any better by repetition.

MR GALBRAITH QC:

Except that we went through an awful lot of – I mean all this material was debated before the Court and I can't give you the answer because I don't know the answer to the point that your making to me as a matter of fact.

GLAZEBROOK J:

Well we've got all of the cross-examination.

MR GALBRAITH QC:

It may be, it may not have been but the original cost of course of the stock that was being seconded would be recorded and would be part of the financial, if it's not in this month then it’s in some other months that the cost was incurred, so it's a cost which has been incurred and will have affected the margin at that

date. So somewhere or other its affected the margin, the actual cost. The fact, you're right, at some later date doesn't change that fact.

So what you will find, even if you go to the March group operating reports which was a –

ELIAS CJ:
What about the comment three up about carpet margin dollars were 6.1 per cent below budget on significantly lower sales?

MR GALBRAITH QC:
Yes on dollars because you remember this was a bad month for sales.

ELIAS CJ:
For sales, yes.

MR GALBRAITH QC:
So of course if your dollars are down you're going to have less dollars, there's no argument about that.

ELIAS CJ:
No but what –

O'REGAN J:
But it doesn't tell us what the margin was in percentage terms, does it, by reference to a budget?

MR GALBRAITH QC:
No that's the last bullet point, the margin in percentage terms was up but the dollars were down, we know April was down and if you go to, I think I took you yesterday to the – I'm sorry I just haven't got it in front of me at the moment – the group operating report for April which shows the margins in the dollars and you can see the dollars are down but the margin is up.

GLAZEBROOK J:

What percentage was premium because premium the selling prices were down so the margin certainly wasn't up on those.

MR GALBRAITH QC:

Well again I can't give you the absolute detail but premium and – the two higher categories premium and I'm trying to think what the name was that went with the other category, were the ones where they were achieving the higher margins and those tables we put in in that extra bundle I put in yesterday you will see that –

GLAZEBROOK J:

But not it seems for this operation for April because they said the margins were down?

MR GALBRAITH QC:

Well the point I'm making is that what the strategy was and what's recorded on page 51 of the prospectus was that they were going to prioritise the higher margin sales as against the mass sales. Mass sales are a third category, they're the bottom end category. The top two categories are premium and I just forgot the name of the other category for the moment, but there's two categories, there's not just premium, it's premium and the next category down, that's where the higher margins were. The mass sales are the ones and you remember one of those tables yesterday. Mr Thomas' table in fact showed how the percentage reduction in mass sales as against the other two categories and let me just –

KÓS J:

Premium and middle.

MR GALBRAITH QC:

It's premium and middle, yes, Sir.

GLAZEBROOK J:

And I can't immediately – the middle segment achieved margin budget and the mass segment was 2.3. So middle achieved margin budget.

MR GALBRAITH QC:

Yes.

GLAZEBROOK J:

But premium was down.

MR GALBRAITH QC:

Yes.

GLAZEBROOK J:

And they keep saying it's due to a lower cost mix and favourable operating variances, that's the margin being upheld, that's over the page. You don't know whether this was explored in cross-examination or in evidence?

MR GALBRAITH QC:

Well I don't know that this was specifically explored but the whole question of margin and the strategy and the achievement of the strategy, evidence was led from a number of witnesses, as I said yesterday on the Feltex side of it, and we had Mr Thomas' table, for example, which we have repeated at paragraph 15 of our submissions which shows what I've just been saying, premium and mid-sales up, mass sales down, margin up as against last year so that was the picture, it wasn't just the picture it was what was actually happening. So in April, as we know, April was a bad month so you got a spotty situation in April but the overall result is that which is shown both in the final accounts at the end of June and Mr Thomas' table there and those other tables I produced yesterday all of which show that both sales and margin were up against the previous years, so it was trending upwards, they were up as you see here against budget even in a bad month.

GLAZEBROOK J:

I suppose my issue really is that they knew what the nine months were so there wasn't a surprise there, so to say that everything was trending up when in fact in two of the three months it wasn't trending up and there were issues that happened which is why the explanation as to why they did happen is actually important to materiality and probably how clear it was that there was an explanation before June is quite vital as well because if it's not clear there was an explanation that is basically a sort of one-off variance type explanation then it might be material for the market to make up its own mind whether that is an end to the upward trend or merely a blip which is why I'm asking these particular questions in relation to these two months, rather than something that was know. So of course they got it right.

MR GALBRAITH QC:

Well yes of course they got it right because it was actual, I agree with you there.

GLAZEBROOK J:

Exactly so that's why I said it's interesting the trend upwards but was it really – and of course, more than interesting, I don't mean to suggest anything other than it being very important background to doing that forecasting but nevertheless.

MR GALBRAITH QC:

Well there's quite a few issues in that, I probably missed some of them and if Your Honour could just remind me if I do but the trend upwards when you got to the end of June had continued and it continued as I said yesterday through to the end of December 2004 because the margin was up something like 6.9, I think it was 6.9 per cent in the following six months and it's Your Honour made to me yesterday.

GLAZEBROOK J:

I'm certainly not suggesting that's irrelevant, all I'm really saying is what I really want to know is what was known about at the time about those three months and the bad result.

MR GALBRAITH QC:

Well April what was known was that, and they were told, it's in the minutes of the meeting on the 27th of April and they would've had the Board papers before that but April wasn't going to be a good month and we talked about the calendarisation and the mistake that was made there and then you've got Easter and holidays and there was evidence that foot traffic was down in the malls in Australia because everybody was on holiday and the school holidays et cetera. So that was the understanding at the end of April pre 5 May and in that 27 April minutes you'll recall it was said that for that reason, if not other reasons, also that because March had been a good month, retailers were still moving on the stock they got in March, so for at least two reasons I can remember at the moment for why April wasn't positive but it was said of course at that meeting on the 27th of April that May and June were expected to show recovery. Now what happened was, as we now know of course, is that May didn't show that recovery, although June did show a recovery and the May information, a number of points about it, one is that, as I said yesterday, I'm not aware of any evidence which suggests that certainly the directors knew by the 5th of May that May was a problem. It's said in evidence and it's accepted that Mr Magill and Mr Tolan got daily sales reports but what Mr Tolan said was that it takes up to 10 working days after the end of the month to assess the information for the previous month. Forget about the month you're actually in because you've got to look at your costs and you've got to look at all those factors.

KÓS J:

Well we're not going to know very much by the 5th day of the month anyway.

MR GALBRAITH QC:

No that's the point.

GLAZEBROOK J:

But when you get sales records though surely, do we know what they were?

MR GALBRAITH QC:

No.

GLAZEBROOK J:

Because I would have thought you'd know whether they were likely trending to budget at least on the sales area because I would have thought as management if they weren't you'd want to be out there sort of stirring things up, otherwise what's the point about getting them?

MR GALBRAITH QC:

As I said yesterday, I think I've read most of the evidence. I don't recall the evidence of that Your Honour, and of course you're talking about the 5th of May, goodness knows, was there a weekend in there? Was it three days? I just don't know and so I can't tell you. I can't recall.

GLAZEBROOK J:

So you're talking about the 5th of May? Sorry, I understand that submission, sorry.

MR GALBRAITH QC:

But obviously by the time they come to the 2nd of June because the directors are told on the 2nd of June that May has not been a good month.

GLAZEBROOK J:

Sorry, I can understand that.

MR GALBRAITH QC:

But they didn't have that group operating report that Her Honour's is talking about.

ELIAS CJ:

No, but as we've said we're really quite interested in the actual position irrespective of what they knew at the time which is why we're looking at the commentary.

MR GALBRAITH QC:

Well probably – what I was about to suggest, Your Honour, was that probably the group trading report, those ones we were looking at yesterday, might be a, well –

ELIAS CJ:

But is there anything else you want to say on those two pages for April and, if not, is there anything you want to say on the commentary for the May report.

GLAZEBROOK J:

Because the May commentary, even if they didn't have it, would be good evidence as to what the contemporary view was of the issues in May.

MR GALBRAITH QC:

Well not of the directors it wouldn’t be.

ELIAS CJ:

No the contemporary picture.

MR GALBRAITH QC:

Right, the contemporary picture.

GLAZEBROOK J:

Sorry, a relatively contemporary view of what the problem was in May even if it wasn't known to the directors at the time.

MR GALBRAITH QC:

Well it would and it wouldn't because just for the point I made a moment ago that Mr Tolan’s evidence was it took at least to the tenth working day of the next month.

GLAZEBROOK J:

Sorry, so to say what objectively the position was as at that date.

MR GALBRAITH QC:

As at the 2nd of June they wouldn't, that wasn't the tenth working day of the next month so they wouldn't have the picture that you're talking about in this –

ELIAS CJ:

We're not really interested so much I think in what picture the directors had.

MR GALBRAITH QC:

Well no, except that, well, no, except if you don't know something –

GLAZEBROOK J:

I take your point. Mostly it's likely to be of assistance I would have thought to your clients in the sense of an explanation as to what the situation actually was but I take the point that you're looking at what information would have in fact been available.

MR GALBRAITH QC:

Yes, because you've got to make a materially adverse judgement, that's one judgement we do know you have to make forgetting about everything else, you've got to make that judgement and you can only make in on the information you're provided and we've seen the information that was provided.

KÓS J:

Is that right? I mean there were two representations, I think we agree philosophically there were two representations. The first is the one on registration.

MR GALBRAITH QC:

Yes.

KÓS J:

Which is that there is a sound basis for the forecast.

MR GALBRAITH QC:

Yes.

KÓS J:

The second is the implicit representation that by not notifying material adverse change there's not been a material adverse change.

MR GALBRAITH QC:

Yes.

KÓS J:

Now I'm not certain how much that second question is depend on actual knowledge as opposed to an objective assessment of all available information. In other words, has there or has there not been a material adverse change? And in respect to that point, Mr Galbraith, we are wrestling with what exactly caused the shortfall and there are hares and hounds in this thing. I mean tufters perhaps or perhaps not. Foreign exchange which turned out to be a hare not a hound. We don't know what's caused it.

MR GALBRAITH QC:

Well the evidence that was or the explanation by Mr Magill and Mr Tolan was that, and possibly should go to the 2nd of June minutes again but my recollection of the explanation was – well I think I'd feel safer going to the 2nd of June minutes.

GLAZEBROOK J:

Yes, I think that is probably better.

O'REGAN J:

But the 2nd of June minutes is when they had some sort of raw information?

MR GALBRAITH QC:

Yes.

O'REGAN J:

What's the explanation, once everybody knew exactly what had happened and had all the information and time to process and work out, looking back what do they say were the causes of not meeting that forecast or of coming up with something less than the forecast? We did have the tufters possibly being responsible for three million I think but it was a $7.5 million shortfall. Calendaristion, I don't think it's ever been quantified as a problem and you would have thought that that would have evened out over a period anyway.

MR GALBRAITH QC:

Yes.

O'REGAN J:

If people aren't shopping one day they'll shop the next day if they need carpet.

MR GALBRAITH QC:

Well it did even out in the sense that I was explaining before that for example end of June you've still got EBITDA, you've got your EBIT figures, so that's evened out.

O'REGAN J:

I know that's your argument and I'm not really commenting on that at the moment, I'm just trying to get my head around what is the company saying now with the benefit if hindsight, what was the reason that they didn't manage to achieve their revenue target? Forget about EBITDA.

MR GALBRAITH QC:

Well one of them was the three million shortfall on the solution dyed nylon, I mean that was an expressed reason that was given at the 2 June meeting.

GLAZEBROOK J:

Is that the tufter issue?

MR GALBRAITH QC:

Well –

GLAZEBROOK J:

Mr Weston is just smiling.

MR GALBRAITH QC:

Well solution dyed nylon can be produced by the LCL tufters or the SESS tufters. I can't tell you from that.

GLAZEBROOK J:

So the three million shortfall wasn't due to it not being able to do wool?

MR GALBRAITH QC:

No because that's solution dyed nylon, that's synthetic.

GLAZEBROOK J:

No well I understand that but we –

MR GALBRAITH QC:

Nothing to do with wool.

GLAZEBROOK J:

Okay, so because SESS machine was out of action it couldn't do the solution dyed nylon either?

MR GALBRAITH QC:

If it was out of action, Mr Weston will comment on that. I don't know that the evidence is, with great respect, is at all compelling as to when – it was out of action at some stage but when it was – it definitely was there as Mr Weston will tell you.

GLAZEBROOK J:

That was an explanation given later as to three million of the shortfall as I understood it or you say that the solution dyed nylon still?

MR GALBRAITH QC:

Yes the contemporaneous explanation was three million down on solution dyed nylon.

GLAZEBROOK J:

So where do we get that from?

MR GALBRAITH QC:

You get that from page 9812 which is the 2nd of June minutes. Now just remember with respect, at the end of the day there was a shortfall in revenue, well they're talking here between 7.5 and nine, I think it ended up closer to the 7.5, I've just forgotten the precise number, around about seven. $3 million of it straight off the cuff is there. "The impact on delivery time including issue with solution dyed nylon which led to approximately three million shortfall." That issue has been resolved so it's not an ongoing issue, well that's the evidence as I understand it.

The first reason that was given was that the gross rebate scheme for retailers meant there were good sales in March, the market slowed in April and May, retailers take longer than expected to move the stock, in addition the scheduled April plant closures for maintenance resulted in the company not being able to deliver certain sales orders by the required delivery dates and they go on to say that discussions with key retailers indicate the market is lifting and with their forward orders and there was evidence from Mr Tolan or Mr Magill on forward orders, they think they'll exceed June revenue forecasts by two to three million which they did and then in July they were pretty much on target as my recollection is and as I said through till December '04 they in fact lifted their margins by another six, I think it's 6.9 per cent and that's reflected in the half year report which doesn't come out till February but the half year report also noted that there had been – that there were problems on the horizon in Australia and as we know Australia fell out of bed subsequently or at that time, New Zealand didn't, New Zealand sales continued to hold up but when you're selling roughly 80 per cent in Australia and while it's correct what His Honour Justice Kós put to me about the translation effect, in fact

when one looks at the half yearly report at the end of December, the translation effect, the adverse translation effect is noted there in a sum, and I'm going off the top of my head, I think $6 million and there was a strengthening New Zealand dollar against the Australian dollar.

O'REGAN J:
What's the reference to the report?

MR GALBRAITH QC:
I will just find it for you Sir. It's 9485 and it's not in the consolidated bundle so you won't find it there, so it's volume 229485.

O'REGAN J:
Sorry, say that one again?

MR GALBRAITH QC:
9485.

O'REGAN J:
9485.

MR GALBRAITH QC:
And it's just to check what I was saying off the top of my head is right, "EBITDA was up 6.9 per cent supported by an increased EBITDA margin which improved from 15.4 per cent from 13.4 per cent. Revenue was down as the company maintained its focus on the higher margin segments of the market. The translation impact of the stronger New Zealand dollar and the groups Australian sales adversely affected reported revenue by $6 million, 3.5 per cent adverse impact on reported operating revenue and EBITDA by 0.7 million," and it goes on somewhere here to say but things are looking a bit – "Carpet demand will present challenges to the group over the next six months particular in the Australian volume segments of the residential market. We anticipate a reduction in group sales in those segments." So through to December 2004 that trend which, with respect I think, the tables that I've

taken the Court to does show was continued but, as I say, things fell out of bed in early 2005.

ARNOLD J:
Just on those tables you took us to that showed the trend of increasing EBITDA over the previous was years, wasn't it, it was an annualised table I think?

MR GALBRAITH QC:
Yes, but it was a six monthly one I think.

ARNOLD J:
Six monthly, yes. I just, in the light of that wondered about, I think I've lost it now. Yes, that email of 9 June 2004 from Mr Thomas where he talks about the company being bankrupt 18 months ago. Now was the explored in?

MR GALBRAITH QC:
Yes, Mr Thomas gave evidence on that. Can I just, sorry I don't want to divert off that. Can I just come back to that just to finish off that the other place – can I just finish off that answering His Honour Justice Kós .

ARNOLD J:
Yes, go ahead.

MR GALBRAITH QC:
The other place to look, Sir, is the 12 month report for the period to end June 2004 and you find that at, I've got the case reference, 9389 but that will have a, I think that's got a consolidated bundle reference too which I will see if I can find. Yes that's 331, document 331 of the consolidated bundle. If one goes there, there is an explanation which is what Your Honour's asking about. You will see on page 9389 which is the Chairman and Chief Executive's overview. They talk about the float. "Improvement in the group's financial performance," in the second paragraph for the year ended June 2004. Third paragraph, "Group recorded a net surplus of 11.2 million compared to

6.8 million the previous year. Exceeded the public offer prospectus forecast by 1.1." There is then a little table which sets that out. "Net profit after tax was up 27.2 compared to 8.9 the previous year, an $18 million improvement. Revenue increased to 328 million compared with 314 million. Factors identified, sales of higher value products in the better margin segments of the market. Completion of the installation of – they relocated spinning equipment to New Zealand so they had additional capacity to service the middle sector of the wool carpet market. New products as a result of the investment in new tufting technology products being well accepted by the market, sales were above expectations, generally favourable market conditions in Australia and New Zealand and that changed subsequently, actual operating revenue was 7.7 million lower than forecast mainly due to the following and then you see the lower forecast sales in April and May 2004, particularly in the lower price value segments of the business."

GLAZEBROOK J:
Well that doesn't actually seem to be right because it wasn't a premium that was weighed down.

MR GALBRAITH QC:
No I think you'll find Your Honour that that is correct that the –

GLAZEBROOK J:
Well mass was only 2.1 or so down.

MR GALBRAITH QC:
I haven't got both in front of me at the moment. I think when one goes to the numbers that will be correct.

GLAZEBROOK J:
Well might be because it's second-hand goods but I mean frankly that's pretty misleading.

MR GALBRAITH QC:

Well I can't accept that Your Honour with great respect.

GLAZEBROOK J:

Well not that it matters, it's not before us but it does strike me as misleading.

MR GALBRAITH QC:

Well not if you look at any of those tables that we've got because they all show that it was the mass sales which were down and the premium and mid-sales that were up.

GLAZEBROOK J:

No April and May.

MR GALBRAITH QC:

Your Honour I haven't got those two documents in front of me at the moment.

GLAZEBROOK J:

Well that's what the comment is related to, not the year.

MR GALBRAITH QC:

I understand what Your Honour is saying, all I'm apologising for, I haven't got the document in front of me at the moment, so I'll go back and have a look. The shortfall to some extent was made up by the stronger than forecast sales in the month of June, sales were below forecast in the fourth quarter. The group achieved a superior product mix of sales yielding higher than forecast margins. We look at that yesterday and they did. Those three group trading reports I showed you for April, May and June show a higher margin than was forecast and budgeted.

GLAZEBROOK J:

Well that's because of the lower costs they say which presumably is related to second-hand – we'll have to look at the evidence on that.

MR GALBRAITH QC:

The translation impact, you'll see the next point Your Honour, the translation impact of the stronger New Zealand dollar in the month of June on the group's Australian sales when translated from Australian to New Zealand dollars for reporting purposes. So the translation impact adverse came in in June Sir, that's what reported there and accordingly the operating revenue shortfall was disappointing. We are extremely pleased et cetera, et cetera, et cetera and the evidence was that here this was explained, the fact that there was a 7.7 million shortfall and the market said effectively so what and analysts buy, two analysts buy or accumulate and it wasn't regarded as materially adverse, that shortfall in sales because EBITDA et cetera and margins were being preserved. I probably haven't answered all of that matters that you raised with me Your Honour, oh I'm sorry I've got to deal with Mr Thomas' email. Mr Thomas gave evidence on that Sir, both I think in his evidence-in-chief, in his brief and I'm just not sure about cross-examination. Now Mr Thomas' evidence is in your consolidated bundle I think at tab 145, it's also in the case on appeal at 3259 and the paragraph –

ELIAS CJ:

Sorry could you tell that to me again.

MR GALBRAITH QC:

Yes I'm sorry, 3259 in the case on appeal, 145 in the consolidated bundle and is paragraph 117 of the brief and what he said was, "On the 9th of June I sent an email to Richard Winckles. Richard had previously worked at CSFB Private Equity where he had been head of Private Equity in Europe and a co-head of international. He was now at a different company. Richard had been a supportive colleague to me and had also visited Australia and New Zealand during the period when Feltex was faced financial difficulties. He had indicated he would support CSFB Private Equity helping the company if necessary even though it was a legacy asset because he could see the potential to turn the performance around. In my email I told him about the Feltex sale and wrote that it had been a 'tough deal with every man and his dog trying to get as piece of the pie'. I was referring here to some difficult

negotiations of the equity incentive plan which I will come back to shortly, and also to discussions with First New Zealand Capital and Forsyth Barr as to the respective fee entitlements after the offer. I have also noted that 'market turned quite negative during the book build phase,' which was a reference to the softening equity market conditions I've already mentioned. I've wrote that I was pleased the deal was done and 'There is some goodness left but we squeezed most of it out, not bad for a company that was bankrupt some 18 months ago.' This was a flippant comment, what I meant by that comment was that CSFB had realised a good price but there was still upside for the new investors. I referred to the lemon because the senior executive at CSFB Private Equity in New York had referred to Feltex as a lemon of an investment when its performance was struggling in 2001 and 2002. My reference to bankrupt was obviously not literal in New York during the period of financial difficulty in 2001/2002 several executives had simply stated, 'We should just let Feltex go bankrupt.' The 18 months was also a bit of an exaggeration. As I have said this was an email written to a supportive ex-colleague with whom I had been through some good and tough times including with Feltex. It was drafted in the manner of a personal email to him, a bit tongue in cheek and it was not meant to be taken literally," and the evidence was that Mr Thomas who had, there was an equity incentive scheme for the for the directors which Your Honour will be aware of. He took up his full entitlement of, I think it was 800,000-something shares which is about $NZ500,000 and he subsequently bought further shares in Feltex. Mr Saunders also bought further shares in Feltex. Mr Magill was buying shares in Feltex not only at this time but subsequently when you might say there were difficulties being faced he was still buying shares in Feltex and of course Mr Thomas sent that email to CSFB in I think about March of this year saying that Feltex was humming, I think those were the words. So that's the evidence that I can take you to, Sir, which puts that into the context of his explanation in any case.

ARNOLD J:

And there was no cross-examination on it?

MR GALBRAITH QC:

I'm sure there was, I'm sure there was. Yes, now that we find out case on appeal volume 9 at 3357 and I haven't got a reference to the consolidated bundle.

GLAZEBROOK J:

I'm not sure we've got that.

O'REGAN J:

No we haven't got it.

GLAZEBROOK J:

3357 did you say?

MR GALBRAITH QC:

3357, I'm just looking to see if – no, I don't know that you have. 3357 and 3374 I don't think that's in the consolidated bundle.

GLAZEBROOK J:

If you give me a moment. Do we know what volume of the case on appeal it is?

MR GALBRAITH QC:

Yes, it's volume 9, Your Honour at 3357. I will just have to try and find it, I'm afraid.

GLAZEBROOK J:

Okay, I've got it, maybe. Here we go.

MR GALBRAITH QC:

Your Honour is doing better than I am at the moment I'm afraid.

KÓS J:

It starts at 3374 I think.

GLAZEBROOK J:

3374?

MR GALBRAITH QC:

There's 3374 to 5 but it starts, the original cross-examination I think is 3357.

GLAZEBROOK J:

It is, yes.

MR GALBRAITH QC:

That's right, and this particular cross-examination, yes, 3374. He was taken to that email and surprisingly, and to his brief on that page and perhaps line 22, "Indeed at 117 that I was intending to answer yes, as I say in my brief Mr Forbes, every man and his dog, colloquial expression, we had a few issues on the plan Your Honour and they were in discussions with, I don't think they'd started but they were beginning to start. The joint lead managers on their incentive fee for successfully completing the transaction and when he went on to say pleased it's done et cetera, there's goodness left in the lemon." Answer, "Well Richard is a very experienced investment banker, a very experienced private equity investor and we had in mind that he would achieve the objectives in Feltex the private equity fund would have achieved, we had added as much benefit to this company as we could absent doing another major bolt on as it's called, another acquisition, we'd basically brought this company through, there was little private equity could do going forward, I thought it was better that it be in the public ownership, so what I've said to Richard here is essentially it's private equity invested, we've taken this business to the point where it's the right time to sell it, as I say because –"

GLAZEBROOK J:

Does he speak the same language as other people?

MR GALBRAITH QC:

No.

GLAZEBROOK J:

Or is this just a special investment banker way of saying something quite different?

MR GALBRAITH QC:

Well I mean he's simply expressing –

GLAZEBROOK J:

He's giving his explanation of what he understands by an English phrase is he?

MR GALBRAITH QC:

Yes if you're looking at private equity investors that's of course exactly what they do, they buy at one price and they try and put the company into a position where they can sell at a better price. Not much point buying if you're not trying to sell at a better price and what they do of course, they leverage the company up, they gear it up to billy-o with debt because they don't want to be putting cash into the business and –

ARNOLD J:

I mean that's an area where EBITDA isn't a great measure is it?

MR GALBRAITH QC:

No EBITDA – no sorry, well it depends what Your Honour means by that. EBITDA strips that out.

ARNOLD J:

Yes I understand that.

MR GALBRAITH QC:

Yes.

ARNOLD J:

But I thought one of the problems with EBITDA was if you had a highly leveraged company carrying a lot of debt, then on some measures, if not an EBITDA measure it may well be unprofitable.

MR GALBRAITH QC:

That's absolutely correct Sir and that's why – but that is also one of the advantages of EBITDA because it strips that out and you can then compare apples and apples and part of the purpose of this float of course was that they were going to repay 50 odd million, it might've been $60 million worth of bonds which were fairly high interest rate, so they were reducing the debt level and you can see it and there's plenty of information there which shows that effectively – and of course – but the debt level didn't go down to any significant extent in this year we're looking at, the 30 June because there wasn't an allotment until the beginning of June, so you're only get one month's benefit effectively and that's another reason, of course it was expected that in 2005 where the interest burden or cost would be substantially reduced that you would be getting – you could be confident about your profits. So, you know, in any event, as I said, people like Mr Thomas were happy to leave their money in because they thought that – and then I think the cross-examination after that, well the cross-examination after that goes on to talk about the decision being made at that time to do the IPO and what Mr Thomas thought about the future prospects and one of the things he was saying, yes things go in cycles and from a private equity point of view it didn't make sense to stay in and try and ride through another three to five year cycle which is what tends to happen in the world.

KÓS J:

Lines 8 and 9 are reasonably clear.

ELIAS CJ:

Sorry which page are you on.

KÓS J:

3375. And that suggests that the lemon expression, at least as far as Mr Thomas is concerned is a historical one?

MR GALBRAITH QC:

Yes he certainly said that Sir. In 1996/97 they went through a tough period and I thought he'd actually said more about this somewhere else but on my feet at the moment I just can't identify it. And perhaps, I don't want to dwell here longer than I have to but the other matter which if you do have those full group operating reports, if I could just ask you when you do have a deeper look at them, if you look through that that section, it's section 10 I think in those reports which is future, and again I've now lost the phrase again but it's the one which –

GLAZEBROOK J:

Sorry, I'm lost. What report are you talking bout?

MR GALBRAITH QC:

Those group operating reports, we were looking at the – you'll find, I think it is section 10 in those and each of those reports there's a survey, as I said yesterday, of the future prospects for residential, New Zealand residential, Australia commercial and New Zealand commercial Australia and if you, of course they are like the carpet sales, there's always positives and some cautions expressed but over this whole period, as I read them in any event, they were signalling the company's belief that for the foreseeable and in fact looking for some future uplift in 2005/2006 they believed that the future prospects were positive and weren't sending a warning signal such as that of what actually happened in the beginning of 2005 with the collapse in the Australian residential market. Section 11, sorry, I've got my numbers wrong.

GLAZEBROOK J:

Was there anything else you wanted to say? I think you did answer the questions I had.

MR GALBRAITH QC:

No, I'm just flicking now at the April group operating report and I know Your Honours are going to look at it so I think it's probably better I – I thought I was going to have a quiet morning.

GLAZEBROOK J:

Was there anything in particular you wanted to draw our attention to, just the schedules?

MR GALBRAITH QC:

I think if you do just flick through it, Your Honour, you will get a much more – because I think Her Honour, the Chief Justice is quite right, that one-pager is a, you know, a one-pager and you will see that there's a very comprehensive commentary contained in that report and there are good things and there are not such good things, that's the nature of business, or this sort of business in any case. No I would retreat if I may.

ELIAS CJ:

Yes, thank you for that and I'm sorry, Mr Weston, we've delayed you.

MR WESTON QC:

May it please Your Honour, after that excitement I'm sorry we've got tufters to come but there's just a couple of other things as well. I will cover some factual issues pretty quickly I hope.

So Mr Magill, if I could just explain, was separately represented even though he was obviously one of the directors, and I undertook that task for a number of reasons, one of which was that there was a separate cause of action against him, the second cause of action, the Fair Trading Act one concerning the forward dating and in the end that came to nothing, no final submissions were made at the High Court trial, it wasn't withdrawn, so just nothing came of it. It was also thought that because he was the only executive director that his position being both management and a director, might mean that there were different considerations, so I came in to look at that and there were a few

other things but because he was the only executive director, it fell to me to deal with a number of the sales and marketing and factual issues. So ultimately tufters fell into that category which is why I was the lucky counsel who ended up carrying this and I'm still carrying it, sort of but in terms of how he was dealt with by the High Court and the Court of Appeal, Mr Magill was treated ultimately just as one of the directors, there were no distinguishing factors drawn or made against him.

He did not deal with the financial issues so much as he said that wasn't really his strength and Mr Tolan was the man who dealt with the financials. So those two obviously worked closely together but in terms of financials Mr Magill generally deferred to the expertise of Mr Tolan and you'll see that if you were to read his cross-examination for example, a number of times he says, "Well Mr Tolan said" and we'll come to that in relation to tufters in just a moment.

Yesterday a question arose about his resignation, that was Mr Magill. He left as CEO in August of 2005. When the poor results came in, in 2005 he offered his resignation and said there should be someone accountable for that and his resignation as CEO was accepted. He stayed on as a director for a few more months towards the end of the year.

So I handed up, there's a piece of paper that looks like this that came to you, if I might just quickly speak to that. This is a summary of the appendix to our submissions, the factual issues and you'll see down the left-hand side 1 through to 10 and that's just the order in which we address these factual issues, imports, Godfrey Hirst and so on and then the chart to the right says, first column, "Were these issues pleaded?" Many of them were but a number were not. References in the High Court judgment, what happened in the Court of Appeal and whether they were mentioned in the application for leave. 4 and 5, the MIP and the extended credit terms are what we heard about yesterday from my learned friend Mr Galbraith. There's just one extra detail on the MIP thing I'll give you in a moment. EBITDA, which His Honour Justice Arnold mentioned a moment ago, while it's mentioned in dispatch, it

doesn't seem to be pursued here. There is a potential pleading issue there because as we say yes and no for pleading, what now seems to be the argument appears to us to be an unpleaded development but it may not matter.

Now just a couple of things, why I was going to refer to this table, in the course of going through those April and May group operating reports, so I'm back into that dangerous territory, you will have seen a number of references and my learned friend Mr Carruthers referred to what's number 2 on that list, Godfrey Hirst and number 8, Jim Smith Carpet Call and there was some adverse comments in those reports and he mentioned that in passing, apparently casually but of course designed to highlight that here was some bad news in those reports. So just in relation to those two points, without re-opening everything else that you've just discussed with my learned friend, the Godfrey Hirst issue was covered quite extensively in the High Court, you've got the references there where that argument was dismissed that that was a concern and if you flick down to number 8, Carpet Call, you'll see in the High Court that too was dealt with, 15 paragraphs, very extensively and any concerns about that were dismissed. So just two bits of context within those group operating reports Your Honours which had been addressed and had been found not to be the concerns that were suggested.

In terms of the MIP issue if I might, you'll see there under the High Court judgment two references where Justice Dobson dealt with MIP. He said it was only mentioned in a footnote, that's the only reference that was in the final closing submissions. And you may recall that yesterday there was a reference to the finding that this was reversed in May of 2004 and I think one of Your Honours said, "Well how do we know that?" And the answer, as Mr Galbraith suggested, was because that was when it came out of the monthly accounts.

But it appears, I would suggest, that His Honour Justice Dobson who said it was May 2004 that it was reversed in these paragraphs in his judgment. The footnote in the closing submissions from the High Court from my learned

friends, and if you wish to see this we've got a copy. The footnote 329 said, “In May 2004 the management incentive programme was reversed,” and that's basically the only reference that was made in the High Court to MIP was in that one footnote and it's perhaps there that Justice Dobson felt confident to say it was May 2004, although that does appear to be what the records show as well. So that was really all I was going to add about MIP.

And then before I leave the factual issues can I just say about that point about the school holidays using that hideous word calendarisation. There was no cross-examination that I recall of anyone about that, certainly Mr Magill was not taxed about why there appeared to be that problem. So that would be subject to any questions, all I propose to say about what we’d covered in our appendix.

So if I could come now tufters, and hopefully reasonably quickly as well. Can I start with the prospectus, Your Honour, because the tufters were mentioned in the prospectus and I know there has been some mention of this but if I could remind you of that. Page 47, intrinsic page 47 in the prospectus.

GLAZEBROOK J:
Can you give us a case on appeal.

MR WESTON QC:
An electronic number too?

GLAZEBROOK J:
No electronic is a bit annoying.

MR WESTON QC:
The tab?

GLAZEBROOK J:
The tab.

MR WESTON QC:

Now that's defeating me.

ELIAS CJ:

It's tab 321.

MR WESTON QC:

321, yes.

ELIAS CJ:

And what was the internal number?

MR WESTON QC:

47, Your Honour. And you will see on 47 when we get there, there's a map of Australia.

GLAZEBROOK J:

Have you got a case on appeal number? Half the pages aren't numbered.

MR WESTON QC:

Yes, this one actually is but I agree it's hard to navigate, 9220.

GLAZEBROOK J:

Thank you.

MR WESTON QC:

So at 9220 if everyone is there. The map of Australia, drop down just below that second paragraph, "In the last 12 months Feltex has installed an SESS Tufter, LCL. These machines are at the forefront of tufted carpet," et cetera. It does down a bit, "Carpet produced by these machines is projected to continue to contribute to Feltex's revenue and earnings through to 30 June 2005 initial demand. The carpet produced has exceeded expectation," so there was that reference. And if we flick through, that's the main reference but there's just two more at intrinsic page 82, and I can give you the Supreme Court number, 9255, so page 82 or 9255 and if everyone is

there, bottom left-hand corner there's a number of bullet points. The third one down, "New unique products introduced in May a result of investment in new tufting installed in June 2003." And then an even shorter one just over the page and you will see on the left-hand column just over half way down, well half way down there is a bold heading, "First half of financial year 2004," that text towards the end of that first paragraph, "To be manufactured by the tufting technology." So those are the references to tufters on the prospectus.

And my learned friend, Ms Mills, said that her team learned of this during the Thomas evidence. With respect we would not accept that, (a) because it is there mentioned in the prospectus, it was in lights to some extent that that was an issue but –

GLAZEBROOK J:
I thought it was the problems that they'd learned during cross-examination not that there were tufters?

MR WESTON QC:
Yes, and I'm just coming to, so it's mentioned that the tufters were a contributing factor in the prospectus. Then the four witnesses that we called, Magill, Tolan, Thomas and Saunders all mentioned tufters affirmatively. Now my learned friend took you through the Thomas evidence. Those various extracts with respect don't say anything about there being problems. It ultimately came out as we say in the seventh week with the tail end directors, particularly Mr Horrocks, with the result that nothing was put in relation to the key allegation which I'm going to come to in a moment, to the critical witnesses who were Tolan and Magill. So I'll talk about that in just a moment.

ARNOLD J:
Can I just, before you do that, at 47 of the prospectus, you've pointed to that reference to the installation of the SESS and the LCL machine, "Initial demand for carpets produced from these machines has exceeded expectations." So when was it that the problem emerged with the SESS machine?

MR WESTON QC:

Well I was coming to that Your Honour but I can jump to it now. The answer will disappointingly be we can't be sure because the evidence is confused on this. I can try and give you some dates. It seems that those two machines were installed about June or thereabouts of 2003. It would appear that in commissioning of the SESS tufters there was some problems that did involve wool that were then overcome. It would seem that at around about April and May of 2004 there was some other problem, this time involving the LCL tufter which makes the solution dyed nylon and that was the problem that's the $3 million problem if I can call it that. It appears that there may have been another set of problems in 2006 because there's a cryptic reference in a February 2006 minute of the meeting of the audit committee but there's no real evidence as to what that meant.

In the middle of what appear to be those certainties though there are a lot of uncertainties. Mr Magill spoke of the $3 million problem as if it was tied to the SESS tufter but confusingly he didn't do it by reference to that page in the 2 June minutes, he said oh Mr Tolan had said this in his evidence which was a week or two earlier. Mr Tolan in fact hadn't quite said that. So there's a possibility that Mr Magill jumped to a conclusion that what in fact was a $3 million problem arising out of the LCL tufters was the SESS tufter problem with commissioning. Now all of that is only speculation and why we're all chasing our tails around trying to sort this out is because the issue, we're all trying to reverse engineer it now from a limited range of materials where the issue wasn't put front and square.

GLAZEBROOK J:

Well actually what you really are saying is that the three million hole that's referred to in the 2 June minutes was an LCL problem that according to the minutes had been fixed.

MR WESTON QC:

Yes, yes, it was a two month problem Your Honour.

GLAZEBROOK J:
So the three million isn't anything to do with SESS from the sound of it unless there's another three million that's to do with SESS but we don't know enough about that.

MR WESTON QC:
No.

KÓS J:
I suppose the other point you're also making is if we're all hunting for the holy grail of what actually caused this shortfall to occur, it's brightly obvious from page 9812, those 2 June minutes, that there's a problem with SDN.

MR WESTON QC:
Yes, not wool.

KÓS J:
So it's not something that so much arises from Mr Thomas' evidence as something that's there in the discovered documents, on the very point that we are struggling to understand which is what on earth caused the shortfall.

MR WESTON QC:
Yes and my learned friends, you'd have noted had proffered a potential pleading if they were forced to plead this and their pleading focuses on wool and SESS tufters can't do wool to put it crudely and the only reference in any of the materials that I can find as to this minute in February 2006 from the audit committee, very cryptic comment where it says the Board learnt that SESS tufters can't service wool and that's all it says.

GLAZEBROOK J:
Well no the CAPEX report actually mentioned the difficulties or somewhere it mentions the difficulties in terms of wool but what you're saying is it's nothing to do – the three million was nothing to do with that.

MR WESTON QC:

No.

GLAZEBROOK J:

The three million was the LCL machine that was fixed up?

MR WESTON QC:

Yes.

GLAZEBROOK J:

And it was synthetics not wool?

MR WESTON QC:

Yes, Your Honour, and can I just pick up on that.

GLAZEBROOK J:

That's all we need to know really.

MR WESTON QC:

Well can I just add though one thing? Your Honour has obviously assumed that the CAPEX review, this is the one that misses even second page, is clear that it is a wool problem, with respect, it's not – all the CAPEX review says in my respectful submission though of course every second page is missing, is that there were problems –

ELIAS CJ:

How on earth did that happen?

MR WESTON QC:

Well Your Honour, my learned friend Ms Mills made the comment that we assembled the bundle which the defendants did because it was getting a bit out – anyway we took over the job and did it but it was their discovered document that went in, it was discovered in that form.

ELIAS CJ:

I see.

MR WESTON QC:

And it was their nomination for the bundle so it doesn't really matter how it got there, what I'm guessing Your Honour is that someone at some point photocopied a document that was a two-sided document and just –

KÓS J:

Why wasn't time taken to find the real one which must have been discovered?

MR WESTON QC:

Well I can't really answer that one, Your Honour, but it was put in that form and to those later tail end directors none of whom who had seen it before. I think all of them had gone by that stage perhaps, by the time it was prepared in November 2005. So we came at it really the only way we could to say, well it wasn't pleaded, how could we have dealt with it. We didn't know it was coming, it's all turned into a bit of a mess, let's not make findings on it. And the Court of Appeal said two things, one is we won't allow the pleading but also the evidence is so unsatisfactory, I think was the term, and for the reasons Justice Glazebrook that I have endeavoured to summarise and you came back with an even shorter summary, we would say yes it is unsatisfactory, we are all confused, we can't be precisely sure what it is.'

GLAZEBROOK J:

Well in any event, it doesn't matter whether it was a wool problem or a synthetic problem, it doesn't seemed to have caused the three million shortfall.

MR WESTON QC:

Well not the wool didn't, the solution dyed nylon was a one-off it seems for a couple of months.

GLAZEBROOK J:

I'm sorry, I meant that machine doesn't seem to have caused that and no one is suggesting it did, at least on the directors' side?

MR WESTON QC:

No, definitely not on our side, Your Honour, no.

GLAZEBROOK J:

And if it did cause an extra three million it would be in your interest to say that it did cause that because it was a fixable problem but that's not what you're saying.

MR WESTON QC:

Well we are saying there was an identified problem with solution dyed nylon, there was –

GLAZEBROOK J:

With LCL, with the LCL machine that was fixed up.

MR WESTON QC:

Probably the LCL.

GLAZEBROOK J:

Well whatever it was the June said it had been fixed.

MR WESTON QC:

Yes.

GLAZEBROOK J:

The June report said it had been fixed.

MR WESTON QC:

Absolutely.

GLAZEBROOK J:
And we've got nothing to suggest that it hadn't been fixed.

MR WESTON QC:
Yes, I think there's a sort of a hint in Mr Horrocks that it may not have been fixed but Mr Horrocks says he didn't really know the answer and so his evidence is a bit equivocal in the end.

GLAZEBROOK J:
Well I think he was talking about the SESS machine actually.

MR WESTON QC:
I think we were all getting a bit confused by that stage in the trial so Your Honours have probably heard quite enough now of tufters so if there is nothing more I will retire as well. Thank you Your Honours.

ELIAS CJ:
Thank you Mr Weston. Yes Mr Smith.

MR SMITH QC:
May it please Your Honours, it falls to me to deal with items F, G, H and I in the joint submissions which have been put forward and F I suspect will be the longest, the rest relatively short. A good part of F has been dealt with in passing by my friend Mr Galbraith but there are some additional matters I want to raise, I'll certainly try and avoid overlap where I possibly can. The other matters as I mentioned will be quite short.

Turning F, so that's paragraph 75 onwards of the joint submissions. It's on the subject essentially of causation and loss and what the third respondents say is that there are four central submissions under this heading, the first is that a breach of section 33 of the Securities Act isn't in itself a basis for a compensation claim and I'll develop that presently. Secondly, even if that were to be the case but for causation or causation on a but for theory is not the correct approach in respect of a section 33 based claim, that's to say if

you can have one and indeed we'll be saying it's not a correct approach no matter how the claim is based under the Securities Act but I'll come to that as well. The third central submission is that the appropriate measure for quantification of loss is difference of value, namely difference in value of the shares as at the allotment date by comparison with what was paid and thirdly to say, we'll quickly go through what evidence there was at trial on the question of proof of loss according to the appropriate measure.

So first of all section 33 involves consideration of section 33 not just in its terms but in the context of the surrounding and particularly the succeeding provisions of the Securities Act and looking at section 33, it's first of all, it's the number of propositions that can be made about it in opening, first of all that it's concerned solely with the making of offers in the absence of a prospectus. Secondly, it's not immediately concerned with the truth of the contents of the prospectus, other provisions deal with that later on and I'll come to those. Next there's no civil remedy provision which is attached to section 33. There certainly is a criminal sanction for breach of section 33 and that's section 59. Next, there's not ordinarily any loss resulting from any breach of section 33 as the section only concerns offers. So assuming that all that has happened is that there is an offer, then no loss flows from an offer as such by itself. So then turning to section –

GLAZEBROOK J:
I don't quite understand that, the last point sorry.

MR SMITH QC:
Well what's intended under section 33 is simply that there be an outright prohibition on offers without a prospectus and if that's all there has been, then you've breached the prohibition, you're liable in a criminal sense, I'll come on to that presently but if all there has been is an offer then there won't be any loss. The position might be quite different if there weren't the succeeding sections.

GLAZEBROOK J:

Well obviously you'd have to accept the offer before there's a loss but I'm not sure I really understand that the offer doesn't create a loss because the offer is out there for acceptance isn't it?

MR SMITH QC:

Well let me put it this way Ma'am, if all you had in the entire Act for instance was section 33, then section 33 would have to do the work of all succeeding sections. So that would have to deal with the situation –

GLAZEBROOK J:

There would be nothing wrong with that would it? If you're not allowed the offer and you've accepted the offer, then haven't you by that made a loss? It's a *Hickman* sense isn't it?

MR SMITH QC:

The succeeding sections deal with the question of not just an offer but a distribution.

GLAZEBROOK J:

Well I understand the argument about the succeeding sections but I just didn't understand the submission that the offer doesn't create a loss. I mean the offer doesn't of itself unless it's accepted it's an empty – but you assume it's been accepted don't you?

MR SMITH QC:

Not when we are considering section 33 because the very point of section 33 is to deal with a position where there has, for example, been by a person who is unfamiliar with securities law an offer what is in effect a security and it's pounced on by the regulator, either the Securities Commission in these days or now the FMA and there is a prosecution but there hasn't, as yet, been a distribution, let alone a subscript, let alone an allotment, let alone any loss as a result of that. The point being that in the context of this section and the

succeeding sections it's really the work of other sections which deal with the question of loss flowing from, for instance, allotment.

ELIAS CJ:
So are you saying that section 33 speaks only to those offering, it prohibits them, and to regulators?

MR SMITH QC:
Yes, because there is – as we see from the following sections, there is a very carefully worked out statutory code or regime if one likes, setting out what are the consequences both criminal and civil in terms of void and voidable allotments and in terms of compensation of varying types which attach to loss which flows, not from an offer because logically an offer by doesn't by itself cause loss but from allotment, for example, and I think the submission becomes clear when we look at the later provisions.

So going right on then to section 34 which is a prohibition again of a distribution as distinct from an offer. There is a criminal consequence which is section 59. There's no expressed consequence and civil damages but again no loss is likely to flow merely from the distribution of a prospectus, it has to be acted on. Loss of course is going to require subscription allotment and more than just mere distribution.

Then section 37 which prohibits allotment of a security absent to prospectus and in the first consequence is criminal as per section 59. Civil consequences do obviously follow which is the first is that the allotments are void under section 37(4). The second civil consequence is that subscriptions are to be repaid which is provided for under section 37(5) and if the, for that purpose it is anticipated in the Act I think under section 36A that the subscriptions pending repayment will have to be held in trust and if that hasn't been done then section 37(6) comes into effect which requires the directors or the issuer to repay out of their own resources if the monies haven't been held in trust.

There's no loss or right to compensation for a breach of section 37 except and unless there is an application for relief and the application for relief provisions follow as you will see in section 37AA. It's not my purpose to go through all of those quite detailed provisions but of significance for the present purposes in terms of statutory consequences, in terms of an order for compensation are that if you make an application for relief then under section 37AG the Court can make an order for compensation, you'll see it in section 37AG(1). "The Court may on the application of a subscriber order an issuer to pay compensation to the subscriber for any loss or damage suffered by the subscriber that is caused by a contravention of section 37." And one might think that that is perhaps, depending on the nature of the relief, which is provided a compensation order, for instance, for financing costs or something similar but in all likelihood given that there is an application for relief which may be granted it's going to fall short of repayment of the entire subscription.

But that's what the Act so far talks about in terms of civil consequences, that is to say for void allotments entire repayment reaching into the issuer's own pocket, if need be, because they haven't held the monies in trust, or if there is an application for relief then you get whatever compensation may be due on application by the issuer. And then the next provision is section 37A. It's a good a point as any to stop, Ma'am, according to my computer it's 11.30.

ELIAS CJ:
Yes, thank you, we will take the adjournment now.

COURT ADJOURNS: 11.30 AM

COURT RESUMES: 11.50 AM

MR SMITH QC:
I wanted to move next and without delay to section 37A which is voidable allotments. It prohibits allotments if there is a prospectus but it's misleading in a material particular and of course it requires knowledge by the issuer that that is the state of affairs as well. The result is again criminal as it is for all the

proceeding and succeeding sections relevant in this part. The civil result is that the issue is voidable depending on notice which isn't a factual issue here of course because it was never given. There's no loss compensation except of course repayment of subscriptions in the event that the voluntary step of avoiding the allotment is or the prospectus is taken and you get full repayment of subscriptions.

The only exception to that remark about there being no loss compensation under this part of the regime is that of course there is also provision in the case of voidable allotments for an application by the issuer for relief and if that application is made, then as was the voidable allotments set of provisions, there is provision for there to be compensation which I think you find at section 37E which talks about other orders which may be made by a Court on an application for relief in respect of a voidable allotment. So if you're looking at the same volume it's page 618 of the old statute.

So 37E, other orders of the Court may make in relation to relief orders under section 37C or D. So there's an application for relief under section 37C and that's just an equitable provision and then again under section 37D, if there's a contravention but that's a very limited purpose section. Section 37F, the Court makes a relief order, then the Court may (a), then "(b) in respect of a security order the issuer to pay compensation to the subscriber for any loss or damage suffered by the subscriber that is caused by the contravention of section 37A and any person who has at any time deemed as security holder et cetera. So again that is a compensation jurisdiction and potentially it's a fairly broad one, you might think in an extreme case it could provide almost as much, if not as much compensation as the full repayment of the subscription but it just depends on a case by case basis.

ELIAS CJ:
Sorry but that's in respect only of 37A.

MR SMITH QC:
A relief application.

ELIAS CJ:

Yes.

MR SMITH QC:

Yes, only in 37A, where it's a voidable allotment and there's been an application for relief.

ELIAS CJ:

Yes.

O'REGAN J:

And there's no criminal sanction there?

MR SMITH QC:

There is a criminal sanction for all of these provisions, 37A it says there can't be an allotment of security in the circumstances set out below, section 37A(1) and if you go to section 59 which is on intrinsic page 662 of at least my copy of the statute in the bundle.

O'REGAN J:

And we've got a slightly different copy I think. It doesn't matter, just give us the section.

MR SMITH QC:

It is section 59 and section 59 says, "Subject to subsection 2, if an offer of security is made to the public or a registered prospectus relating to a security is distributed or a security is allotted in contravention" and then so on. That's section 59. Section 58 deals with the untrue statements and criminal liability for that and since our discussion just takes me to that provision temporarily and I suspect for the last time, the position there is that for an untrue statement one can be prosecuted and the penalty is imprisonment for a term not exceeding five years or for individuals anyway, for a fine of $300,000. Our argument would be that the statement in respect of which one is prosecuted under that provision has to be material, not just relevant but it has to be

material and the only point about that being is that materiality comes to the fore in the defence provisions in section 2 and 4 where all, as His Honour Justice O'Regan mentioned yesterday the statute does is to reverses the onus or shift the onus. That would be in accordance with ordinary criminal law policy in relation to these types of issues because it is after all the issuer for instance or any person who is liable under that section who could be expected to be in possession of the details which would enable them to prove more easily –

ELIAS CJ:
Saying though that a statement was immaterial doesn't really convey the flavour that the statement is not, well I suppose it's the issue that was being discussed with Justice Arnold yesterday that –

MR SMITH QC:
Is it relevant or material?

ELIAS CJ:
Well relevance might be a bit weak but it may not be much more than relevance.

MR SMITH QC:
Fortunately we don't need to solve in my respectful submission that conundrum here.

ELIAS CJ:
Because after all, you know, penalty will look at things such as whether it was significant or not in context.

MR SMITH QC:
Again it's not an issue we have to resolve here except that it is capable of being of assistance simply because the word "immaterial" is used again but against the proposition which Your Honour advances that the question of how material or how relevant as the case may be can be addressed on sentencing,

there is the contrary proposition which is that the mere exposure to three years penalty for imprisonment as specified by the statute tends to suggest the legislature had in mind something more than menial.

ELIAS CJ:
Well obviously it does and materiality is directed at that. It's not something – but whether you go flipping it around to saying that it's something which is causative of actual loss may be going too far.

MR SMITH QC:
Again with the comfort of not having to be right about this, I can say –

ELIAS CJ:
Yes exactly but it is always a good precept to try to be consistent in reading a statute.

MR SMITH QC:
Yes. I suppose the other overall point which tends to suggest that immaterial in all probability goes to value and significantly so but certainly to value is because after all we are concerned with an investment, my investors who are interested in nothing but value. So materiality is almost certainly, I'm not ruling out any other possibility whatsoever but materiality one would think, in the ordinary course, would only ever in the legislatures might have gone to value of the securities or a false statement or an untrue statement which in turn was relevant to that.

So coming back then, there's just in passing section 39 which is on intrinsic page 628, it says the form and contents of the prospectus, every prospectus and registered prospectus shall be in writing and dated, specify any documents required by section 41 to be there, contain all the information, statements, certificates and other matters. It doesn't prescribe that the contents must not be untrue. That again tends to suggest that the truth or otherwise of the statement in the prospectus and the consequences which

flow from that really is dealt with by other sections, just as it's not dealt with section 33 in particular or section 34, neither is it dealt with in section 39.

O'REGAN J:
But it does though, so you've got to comply with the regulations which have those provisions in about certifying that there is nothing untrue I think.

MR SMITH QC:
The question arises and it's really only a question which is when section 33 says that does it mean that the prospectus which you put forward in those days to the Registrar of Companies for approval has to contain, has to have those contents and of course the consequences if it didn't Mr McPherson would not let you register it and then the truth or otherwise of the consequences and the consequences of that are dealt with under the succeeding provisions.

GLAZEBROOK J:
I'm not particularly attracted to this way of slicing it up but I understand your argument that other provisions deal with the consequences of untruths.

MR SMITH QC:
Well I'm glad –

GLAZEBROOK J:
And I mean these are the overall provisions and then the others are provisions that come off that but to say that they are only so narrowly concerned with saying, well you can put in what you like as long as it fulfils those criteria or you can put out what you like as long as it fulfils the criteria. I mean they have to be understood in the context of the whole of the Act and to say that you can put out an untrue prospectus and still comply with section 39 doesn't seem very attractive to me.

MR SMITH QC:

Well that's true Ma'am, but of course that raises the question of whether it's really valid to expose the fallacies in an argument with references to really extreme possibilities and the possibly that Your Honour put forward is you can put in a prospectus what you like. Obviously in a case of bad faith or fraud that could be an issue under section 33 if it got past the registrar in the first place. I certainly take on board what you're saying Ma'am, but it does remain our submission that when you look at the Act as a whole what you find is a carefully designed statutory scheme and it specifies contraventions, it specifies consequences of those contraventions. In all cases they are criminal that's certainly true, the Act is quite clear about that but in some cases the allotment is void and in other cases its voidable. The Act is quite clear about when those consequences arise. It also specifies clear entitlement, if you can make out the relief, the void, avoidable allotments clearly specifies relief in the nature of compensation for damages or the equivalent for loss in those circumstances. It clearly specifies entitlement for compensation for untrue statements under section 56 and so following the scheme of the legislation through.

GLAZEBROOK J:

I understand that submission I just think that to say, well you can put out as much untrue as you like under 39. What I would say is that for a breach of section 39 the Act spells out the consequences or a breach of section 33, the Act spells out the consequences. I can understand the argument put that way and only those consequences are the ones that arise have you breached that, ie, criminal or civil but as set out.

MR SMITH QC:

Yes, there might be a measure of agreement between us, Ma'am, which is to say in looking at section 56 entitlement, for example, you don't overlook what section 33 or section 34 specifies but we'd still say –

ELIAS CJ:

Well the Act is concerned both with content, formal content, things that must be included and worth truth of contents and they are dealt with specifically. I mean it is quite interesting that 37 the heading is, “Void irregular allotments,” I mean maybe an untruthful statement makes an irregularity but it's probably really focused on the formal components that have to be in the offer documents, I would have thought. Anyway, your principle submission is read all of this as a package and when you are looking at an untruthful statement there is a bespoke provision dealing with that and that's really where you should go to.

MR SMITH QC:

That's entirely my submission, Ma'am. So having got to that point I want to then turn to the question of what is the approach to compensation or damages in these circumstances because as I understand the argument, well clearly what was put forward as a but for approach and that involves a consideration of general causation law and I've got a number of propositions and I’ll come to an authority which just helps us get us through all those presently but I’ll simply lay them out.

ELIAS CJ:

What do you mean by general causation law?

MR SMITH QC:

Well I'm going to come to it Ma’am shortly.

ELIAS CJ:

Okay that’s fine.

MR SMITH QC:

First of all that causation in these circumstances ordinarily requires causation in fact and then causation in law. It’s a relatively unremarkable submission at the first page in Todd dealing with this subject.

ELIAS CJ:

I'm never really sure what causation in law really adds to causation in fact.

MR SMITH QC:

Causation in fact, we'll come to it presently, but I mean causation in fact is the historical antecedent circumstances which give rise to a loss, it provides the occasion but for which loss would not occur as a matter of fact and the question of causation in law is generally speaking in information types of cases and again I'll come to it but it's useful to pause now, is more of a question of when you look in information cases at the work which was to be done by the provider of information, what kind of loss was it the duty of the provider of information to protect the recipient against? Is it absolutely everything which may possibly follow as a result of the untrue statement or the negligence or the wrong valuation and entering into the transaction on the strength of the wrong valuation for example or is it simply the consequences of the information in the valuation or the information itself in the prospectus in this case, of being wrong because there's a difference between the two. So that's the second tranche which is causation in law and I'll come to the latest utterance, I shouldn't say utterance, the latest decision in the Supreme Court which is *Hughes-Holland v BPE Solicitors* [2017] UKSC 21 where –

ELIAS CJ:

Sort of redoing Hoffmann?

MR SMITH QC:

Yes.

ELIAS CJ:

But just on that, you see it simply could be, and this is where we use this term materiality, that materiality rather than causation is sufficient enquiry there in terms of supplying the legal component and causation then is left as a question of fact because you say what kind of loss to protect against, well I accept that, that there are some things that will be immaterial in the scheme of

the legislation but it's a pretty low threshold, it's not, I wouldn't have thought a loss causation enquiry that is undertaken there.

MR SMITH QC:

Well I suppose that the position would be is that materiality is a threshold, if you don't have materiality then there's no point in enquiring.

ELIAS CJ:

So I would say that's the legal threshold but then it's all fact.

MR SMITH QC:

No it's then a question of what's the correct measure and what flows. For example one might have a materially untrue statement in the prospectus which once corrected challenges the value or removes the value of the entire security as issued. On the other hand you might have a material statement which has a far lesser effect and it's a question of a combined question of causation and quantification which is looked at there but I'll come to that.

GLAZEBROOK J:

What about, I mean I can understand that when you're talking about how you calculate loss but what about an individual who says well if I'd known that I would not have entered into it? So where are you putting those sort of people? I know that's not a but for causation but it is an individual causation issue. I mean assuming that is the case I suppose and is found to be the case.

MR SMITH QC:

That would be first of all a but for causation because you are saying, just as you are, for example, in the *South Australia Asset Management Corporation* (SAAMCO) cases.

GLAZEBROOK J:

No the but for is just as a matter of law, it's but for is what I understand your friends are postulating but are you saying, I'm just asking what the submission

is really because there could be people who say, “Well I know that only reduce the price that was reasonable to $1.20 but frankly I wouldn't have entered into it had I know that.”

MR SMITH QC:

The answer to that in my submission is clearly provided in *Broome v Speak* which my friend took you to yesterday and that says that the test is an objective one.

GLAZEBROOK J:

Well I think that's slightly different because we're talking about quantification of loss now. So we've got to the stage where an objective investor would have been influenced by this or do you resile from what Mr Galbraith said that that encompassed price sensitive information?

MR SMITH QC:

No we start with a question of whether or not something is material, it's an objective test and as is set out, for example, in *Broome v Speak* it's an unhelpful exercise to –

GLAZEBROOK J:

Can I just check you're not resiling from what was –

MR SMITH QC:

No I'm not resiling, on the contrary I'm repeating what he –

GLAZEBROOK J:

So in terms of Mr Galbraith accepted that anything price sensitive would be material under that test and that you agree with that?

MR SMITH QC:

Well I have to make the qualification which is to say that it has to be material, just because its price sensitive doesn't make it material, it has to be material

and identifiably so. There could be a matter of fact which somebody is going to suggest effects price by an infinitesimal amount.

GLAZEBROOK J:
Well obviously it has to be a material amount, so price sensitive by a material amount.

MR SMITH QC:
It's material materiality. So there's no question about that.

GLAZEBROOK J:
Yes, okay, that's fine.

KÓS J:
Is it a question of whether the investor will invest it at all.

MR SMITH QC:
No.

KÓS J:
That it can't be that?

MR SMITH QC:
No it can't possibly be that because if we go, if you just give me a minute to find it Sir.

GLAZEBROOK J:
Well that's all I wanted to check.

ELIAS CJ:
Yes I think that's probably sufficient and you can develop the argument. We keep interrupting you in developing.

MR SMITH QC:

Yes, what I wanted to just make sure to focus Your Honours' attention on the passage from *Broome*, I'm not going to do it now because you've got it.

ELIAS CJ:
And we have it in our minds, yes.

MR SMITH QC:
So I say we have to have causation in fact and we also have to have causation in law. Generally speaking causation in fact is not going to be sufficient. Causation in law requires consideration of what kind of loss it was the defendant's duty to protect and then the next proposition is that in cases of information cases such as valuation and audits which this is really. If a person is under a duty to take a reasonable care in providing information is liable for the consequences of the information being wrong and not all of the consequences of the action taken and reliance on the information. The best way to get to grips with what really is being said about that now and I know Ma'am there you're ahead of me because you've looked at BPE specifically in relation to this but I want to take you –

ELIAS CJ:
But not in relation to this at all.

MR SMITH QC:
I arranged to have a copy of the decision provided and I hope you've got it.

ELIAS CJ:
It's somewhere, we'll have to look for it because its separate.

MR SMITH QC:
So the passages I particular want to draw your attention to respectfully are firstly on page 1038, paragraph 20, under the heading *SAAMCO* principle. So the passages I particularly want to draw your attention to respectfully are firstly on page 1038, paragraph 20, under the heading, "SAAMCO principle." Courts of law said, "Lord Ashworth and Bishopstone must accept the fact that

the philosophic doctrine causation and the juridical doctrine of responsibility for the consequences of a negligent act diverge." And it goes on to say what Lord Ashworth meant by the philosophic doctrine of causation as he went on to explain was, "The proposition that any event that would have not have occurred but for the act of the defendant must be regarded as the consequence of that act. In the law of damages this has never been enough," and he goes on at the bottom of the paragraph, "The reason as Lord Asquith pointed out is the law is concerned with assigning responsibility for the consequences of the breach and a defendant is not necessarily responsible in law for everything that follows from his act, even if it's wrongful." Then over the page, 1041, across to 1041.

ELIAS CJ:

But we're not in this ballpark are we? We're not in, you know, there's not issues of remoteness here.

MR SMITH QC:

It's not a question of remoteness, it's a question of causation and in my submission this is a case where the position is exactly same as it would be in the valuation cases, where a valuer provides a valuation and in some respect says something which is palpably and identifiably wrong which by itself causes loss and then after the valuation was received, after it is acted on, the property purchased or alternatively leant against, there is for instance a global financial crisis.

ELIAS CJ:

Yes, yes.

MR SMITH QC:

Is the value reliable?

ELIAS CJ:

But no one is suggesting the supervening act or a consequent development other than the investment here, so it's a much simpler case.

MR SMITH QC:

Well it's not – almost as simple but the evidence, and I'll come to it presently, was that, and this is the only evidence on loss and it came principally although not entirely from Professor Cornell and I'm leaping ahead far too much but I will because you've asked but makes it very clear that the securities had value and considerable value, not only on allotment but for some time after allotment and that continued. So in other words the losses are losses which occurred over a period of time which went something in the order of 18 months after allotment. At the end of the allotment and some months later, for example, as you'll see from Professor Cornell amongst other witnesses, once the information was put forward that the sales forecast had not been met, the market information in relation to the share price was precisely zero and this is the only false information in the prospectus that we're concerned about at this stage, concerned about much more at trial and so there is an outright paucity of any evidence whatsoever that there was any loss associated with that. Even if there had been some evidence on that subject, there is precisely and utterly nothing to suggest that it was so far a going as to deprive the security of all conceivable value at that or any later time. Of course afterwards, as my friend Mr Galbraith has taken you to, there was a crisis of consumer confidence in Australia in particular which is thought to have had a pronounced effect on the value of the securities by dint of its effect on the current trading and trading prospects of Feltex. So I'll come to that in slightly more detail.

ELIAS CJ:

I'm just trying to work out whether this is fact. This is just fact isn't it and I think we have it all on board that the market didn't react adversely but that can't be determinative, it's simply an expression of opinion. It's probably a powerful indication but can you say from that or are you saying from that circumstance that it is demonstrated that the untruth, if it were untruth, accepting that it's an untruth for these purposes, was immaterial, that it was or have we moved past materiality here?

MR SMITH QC:

I'm saying it certainly for those reasons was immaterial but it flows on from that as well.

ELIAS CJ:

That there is no loss, yes I understand that.

MR SMITH QC:

In terms of causation and quantification, none of that either.

O'REGAN J:

Well they're two sides of the same coin aren't they?

ELIAS CJ:

Well they're on a continuum.

GLAZEBROOK J:

As far as Mr Houghton is concerned but the other investors – and Mr Houghton really has put all his eggs into the but for basket so hasn't called any contrary evidence so hasn't even attempted to prove loss. I mean there is an application for an inquiry into damages but it seems to me, subject to anything said in reply, that Mr Houghton was told he had to prove it in the first stage of the hearing and if he hasn't then that's his problem but that doesn't apply to the other investors, does it?

MR SMITH QC:

Yes I will deal with both. So Mr Houghton, Your Honour is absolutely right, there was a trial. This matter was to be heard in its entirety. That involved quantification of loss. His Honour Justice Dobson in the High Court clearly and carefully went through the fact that there'd been no attempt to prove loss by Mr Houghton as the plaintiff. He had said he consider the issue of whether or not there should be an adjournment or an inquiry and for the reasons that he expressed he said that there wouldn't be, nor was there, for that matter, any application at the end of the trial to say, "Look we just haven't got up

evidence on loss so we want an adjournment for that to be considered." So the only way that Mr Houghton, and I will come to the others presently, could come back on the question of loss would be to say that there was some supervening event which prevented him from adducing evidence on the question of loss during the course of trial and that would really require him to apply to reopen his case which requires fresh evidence and self-evidently that is just out of the question in my respectful submission. In relation to the rest, this comes on to the question that I was going to deal with separately which is the represented persons and I just wonder if I could slot it in.

GLAZEBROOK J:
Yes perhaps you should deal with it, that's absolutely fine.

KÓS J:
Can we just go back to this evidence about August? Why are we so focused on that? Isn't the real question, because in August there might have been all sorts of positives in the intervening period which meant that the market didn't react, it's not the same market in time as the market in June. Isn't the real comparison between what actually happened and what would have happened if the directors had put out a small announcement saying, "Houston we have a tiny problem here."

MR SMITH QC:
Well apart from its profitability that was the news, namely in August which is only a short time after June, namely that it hadn't met its, amongst other things it hadn't met its sales volumes. So it's the nearest proxy for an indication of loss. The other way to look at this, and again this is a problem which Mr Houghton faced, is to say and I say this in answer to my friend, Mr Carruthers' submission of the first day of the hearing, which is what is to happen, how do you prove loss? Does that mean to say you've got to go into the performance of the company and establish that there was loss and the value of the security? My answer to that is that you do, you most certainly do. All that is required, and again we're talking about a publically listed company with a great many investors, very significant capitalisation and so the amounts

involved certainly justify the expenditure. The expenditure of what? Well the expenditure of doing what is quite normal in these cases and is done thousands of time every year for enterprises throughout New Zealand, of getting a share valuation as at the time of the allotment to show what it should have been and what the correction would have been allowing for the adjustment which ought to have been made. So whether it was done on a net tangible assets basis or on a price earnings multiple basis or as one might think, for example, more likely and more obviously on a discounted cash flow basis, an exercise such as that is perfectly normal, perfectly affordable in the context of litigation of this scale and ought to have been done in order to establish that there was any loss.

Equally the other measure is to say what's the market response? We being under no onus have furnished the evidence of the market response which is very thorough going and clear and that tends to suggest that there was no loss, anyway that's the evidence which ought to have been furnished and I will come to it presently but if the represented persons were to be entitled to have another go the evidence of the type that I've just described is what would have to be put up.

GLAZEBROOK J:

And you will come to if one of them says, "Well I would have been really spooked if I had been told, especially in a correction" – this is assuming there has been an untrue statement and a correction should have been made, "I would have been really spooked because I would have been really worried that it was going back down to where it had been some few years before, before it started going up, that this was the peak and it was now on its way down and I wouldn't have bought. What's your submission on that? Is it still the objective loss that they got? So it's irrelevant what they would've done and how spooked or otherwise they might have been.

MR SMITH QC:

Well two submissions, first of all as per *Broome v Speak* it is irrelevant, you simply –

GLAZEBROOK J:

Well I'm not sure they were talking about loss there were they? They were talking about –

MR SMITH QC:

They were talking about the threshold to loss which is materiality.

GLAZEBROOK J:

Which is they're different.

ELIAS CJ:

They're talking about reliance really which isn't something that we need to be concerned about, given the statutory background.

MR SMITH QC:

If I can just get perhaps –

ELIAS CJ:

Well that was the – but I think we're probably diverting you too much. I think you should probably follow through on the *BPE* case.

MR SMITH QC:

I will come again to – so BPE, the second paragraph I was going to come to is on page 1038, under the – sorry 1041 and at this point Lord Sumption is from paragraph 27 onwards and before then in the process of, as you said Ma'am review *South Australia Asset Management Corporation v York Montague Ltd* [1997] AC 191 (*SAAMCo)* or Lord Hoffmann. So 27, bottom of paragraph 27, last sentence, "Referring to the principle applied by the Court of Appeal that damages should be such as to put the claimant as nearly in the position that he would have been in had the breach not occurred Lord Hoffmann said…" So just before we stop there, that's really the measure that's urged on you by the plaintiff or the appellants in this case to say well if I'd never invested I'd have all my money. So what does *SAAMCo* say about that? Lord Hoffmann in *SAAMCo* says "I think that this was the wrong place to begin. Before one

can consider the principle on which one should calculate the damages to which a plaintiff is entitled as compensation for loss, it is necessary to decide for what kind of loss he is entitled to compensation. A correct description of the loss for which the valuer is liable must precede any consideration of the measure of damages. For this purpose it is better to begin at the beginning and consider the lender's cause of action." And then following on in *SAAMCo*, the citation in paragraph 28 of *BPE,* "On the other hand, the valuer will not ordinarily be privy to the other considerations which the lender may take into account, such as how much money he has available, how much the borrower needs to borrow, the strength of his covenant, attraction of the rate of interest or the other personal or commercial considerations which may induce the lender to lend."

Over the page, 29, again a citation from *SAAMCo*, "It is that a person under a duty to take reasonable care to provide information on which someone else will decide upon a course of action is, if negligent, not generally regarded as responsible for all the consequences of that course of action." That's the but for point, the cause in fact point. "He is responsible only for the consequences of the information being wrong." And that's a deviation in share price, not getting all your money back. "A duty of care which imposes upon the informant responsibility for losses which would have occurred even if the information which he gave had been correct is not in my view fair and reasonable as between the parties. It is therefore inappropriate either as an implied term of a contract or as a tortious duty arising from the relationship between them. The principle thus stated distinguishes between a duty to provide information for the purpose of enabling someone else to decide upon a course of action and a duty to advise someone." And if you take on the role of telling somebody what to do, that's a different state of affairs altogether and different loss consequences and causation rules follow from that.

Then over the page, 1043, here citing again from Lord Nicholls in *Nykredit Mortgage Bank plc v Edward Erdman Group Ltd* [1997] 1 WLR 1627 at (c) in the margin, "However, for the reasons spelled out by my noble and

learned friend, Lord Hoffmann, in the substantive judgments in this case, a defendant valuer is not liable for all the consequences which flow from the lender entering into the transaction. He is not even liable for all the foreseeable consequences. He is not liable for consequences which would have arisen even if the advice had been correct. He is not liable for these because they are the consequences of risks the lender would have taken upon himself if the valuation advice had been sound. As such they are not within the scope of the duty owed to the lender by the valuer."

So the reason why I've gone through *BPE* is not because it says anything new about SAAMCO and *Nykredit* rather that it affirms them but it is just that the ratios of both cases are expressed conveniently in *BPE* in those passages.

What do we suggest that Your Honours draw from that, we're saying that the appellant's causation argument relying on section 33 is that if contrary to section 33 a prospectus does not comply with the Act because it contains an untrue statement putting aside materiality then there ought never to have been an offer of shares, but for that offer none of the subsequent events giving rise to loss would have occurred and therefore but for the offer the loss wouldn't have arisen. And we say that there are two mistakes in that logic, there might be more but two at least. The first is that it ties causation in fact not to the proximate fact allegedly giving rise to a loss, namely an untrue statement in a prospectus, but to an antecedent fact. So it's rather as if the plaintiff in SAAMCO were to be sued in respect of the fact that there was a valuation as opposed in respect of the fact that there was a negligent aspect of the valuation. The second mistake –

ARNOLD J:
What's the antecedent fact you say?

MR SMITH QC:
The antecedent fact is the fact of the prospectus as opposed to anything. You've got to tie your loss to what's wrong with the prospectus.

GLAZEBROOK J:

Well you have a continuous duty to have a true prospectus out there so isn't the act not withdrawing the prospectus when there's an untrue statement? I mean I think your better argument is section 56 specific, as Mr Galbraith said, it explicitly says damages arising from the untrue statement.

MR SMITH QC:

Yes well I'm coming onto that because it says, "By reason of," but that's certainly the case.

GLAZEBROOK J:

Or whatever it says.

MR SMITH QC:

The second point is that the argument ties causation to something which, in itself, is not a legal wrong. In SAAMCO it was not a legal wrong to give a valuation, it was a legal wrong to give a valuation which was negligent in a particular respect and here it's not a legal wrong to have a prospectus, it's a legal wrong to have a prospectus with an untrue statement in it.

GLAZEBROOK J:

Well isn't that the point that's made as that's a legal wrong you're not allowed it there and should have withdrawn it?

MR SMITH QC:

That's why I'm saying that you can't get up, as it were, under section 33. For the present purposes you have to, in my submission, put aside section 33 and go purely to section 56 and section 56 contains what is a proxy or an equivalent phrase of the submission that I've been putting forward to you, namely by reason of, that's what by reason of section 56 means. You can't find as a plaintiff that it's inconvenient or difficult to satisfy the requirements of section 56 by reason of and say, "Oh, well if I can't do that I'll just say there should never have been a prospectus, never have been an offer and I never would have invested." That's not the way the scheme of the Act works.

So I come onto the question of the correct measure. What's of use to you there, Your Honours, is that section 56 and the type of provision it is has been considered in New Zealand in the Court of Appeal in *Murray v Morel* [2007] NZSC 27, [2007] 3 NZLR 721 which is under tab 15 of our volume 1 and it's at paragraph 102 where Justice McGrath in that case says, at line 25, "I see little analogy between the circumstances of the present case and those in the cases where the Court of Appeal has applied the approach it first took in *Hamlin*, accordingly I would not apply the principle of reasonable discoverability to the statutory tort created by section 56 of the Securities Act. So simply that Justice McGrath in *Murray v Morel* [2007] NZSC 27, [2007] 3 NZLR 721 saw the prohibition in the Act, not the prohibition the provisions of section 56 as a statutory tort.

ELIAS CJ:
Well do you disagree with that?

MR SMITH QC:
I'm sorry?

ELIAS CJ:
You don't disagree with that?

MR SMITH QC:
No I don't disagree, on the contrary I'm agreeing with it and I'm simply putting that forward as suggesting in its own right that the ordinary tortious measures, as I've been discussing, is whether it's imposed by contract or a common law duty, is the measure that you would apply in this case. The reason why I'm mentioning it is because Ma'am yesterday and I may have misunderstood what you were saying, is that you might have been attracted to the view that there was somehow a statutory regime which suggested that the measure of damages or the approach to damages was different.

ELIAS CJ:

Well it may, I mean we need to look at the text of section 56.

MR SMITH QC:

Perhaps the most – what could be –

ELIAS CJ:

Are you reading quite a lot into the word "tort" there are you?

MR SMITH QC:

Well to say it's statutory tort, I wouldn't want to give you the impression that I'm relying on that solely. I think what is of more use to you, if the Court were concerned to see if there was something about the statutory regime which really meant that the causation and quantification approach would diverge from tortious –

ELIAS CJ:

Now I think yesterday I was looking at the more threshold thing of whether there was a wrong that was material or not immaterial. I wasn't considering this issue of causation of loss which I agree the statute says has to be linked.

MR SMITH QC:

Has to be linked and I think in that case I can move over quite quickly. The relevant loss measures, and I'll just give you the reference.

ELIAS CJ:

Which is not to say that there is not an untrue statement.

MR SMITH QC:

No, no, that's in the wind. Well the relevant measure is, for an untrue statement is the difference in share value or at least that has been the measure approach in these cases by lower Courts which include *Scott Group Ltd v McFarlane* [1978] 1 NZLR 553 (CA) I think it is which is in tab 22 of our volume 2 and I'll just give you the citation. The relevant passage is on page

585 behind page 22 of that decision and conveniently under the heading of "damages" and the relevant passages, it's really helpful, given it's a short passage on that page for Your Honours to read from the heading down to the bottom of the page but in particular lines 15, 16, "In an action for tort a deceit leading to a contract of purchase the normal measure of damage, the difference between a price paid and the fair value at the time of purchase" and it cites authority for that proposition. There's a reference there, albeit somewhat outdated to *McGregor on Damages* (19th ed, Sweet & Maxwell, London, 2014) at [47-009]–[47-016] and we've put in our submissions the citation for *McGregor* which is updated to the current edition.

Where, at line 20, "the contract has been induced by the negligence of a third party rather than by fraud, I think the same measure should prima facie apply." Then line 35, "To make out its case therefore the plaintiff had to show on the balance of probabilities that the true value of the Duthie shares was less than the true value of the Scott shares issued as a consideration." That's just where there was a merger or an amalgamation and the Scott shares were paid instead of cash. So it's a question of value.

KÓS J:

But how does that work? I mean what factual circumstance provides the information to the market so that you can do the second part of the equation. Is it the withdrawal of the prospectus? No it's presumably notification of the problem.

MR SMITH QC:

Regrettably were there to have been an actual problem we're past that and so it's purely a question of a backwards looking consideration of what the comparative values in the share price and the share value accordingly to whatever valuation means one would adopt at the time of trial.

KÓS J:

So we're not measuring it against an alarmed market we are simply saying if a valuer had perfect vision and assumed the notice had been given what would he or she say it was worth?

MR SMITH QC:

Yes, but I'm just perhaps a little concerned about your qualification which is to say that if a valuer had perfect vision. No valuer has perfect vision but all valuers do. I trust you know what I mean which is that we have to rely on evidence of valuers with all their faults and foibles and their pluses and minuses but that is the means, it's a quantification measure and in any case or any share valuation.

ELIAS CJ:

This isn't a valuation case. It isn't an opinion case. It's a statutory regime which requires information to be provided.

MR SMITH QC:

It's not a valuation case, I accept that it's not.

ELIAS CJ:

So one can see that in a valuation case the correct measure of damage is the disparity in value acquired pursuant to a contract but here it's the fact that the –

MR SMITH QC:

I wonder if that's right, Ma'am, because after all a prospectus is really about value. Of course there's a lot of glossy stuff that comes with it and perhaps feel good about the enterprise –

ELIAS CJ:

But they don't represent what the value is, they're not representing it's worth this, it's a disclosure regime. So against that background is it really helpful to look at – I mean you can say that that's a measure of loss that you could take

but is it the appropriate measure of loss against the statutory background and do you have authorities which actually do grapple with that issue?

MR SMITH QC:
I don't think that there – well there is –

ELIAS CJ:
I don't really find tortious cases concerning valuation as helpful as I would find.

O'REGAN J:
It's got (inaudible 12:42:53) and audit though which is similar.

ELIAS CJ:
Well not but it was whether the, you know, the relationship was a tort.

GLAZEBROOK J:
And you're looking at the fact that the duty there as well.

ELIAS CJ:
Yes, that's right.

MR SMITH QC:
In my submission it's really necessary to look at this at a slightly higher level. This is a statutory tort or a statutory prohibition and it is the same –

ELIAS CJ:
Well I'm not sure that it is a statutory tort. I mean it is a statutory wrong.

MR SMITH QC:
Which is why I'm prepared to say it's a statutory prohibition wrong, I hadn't meant to get hung up on that.

ELIAS CJ:
It's a statutory wrong for which the statute provides a remedy and that's what we're concerned with here, fitting the remedy to the statutory wrong.

MR SMITH QC:
However, that is all completely correct, Ma'am, but when we look at the prescription of the remedy, maybe it's for a statement which is untrue, which is made with a degree of fault because there is a due diligence defence, or that the onus is on the defendant to prove that but the degree is fault is implicit and therefore required, and so it is akin so far in the analysis to a tortuous measure.

In all audit cases there is a statutory requirement of a public listed company, for example, to give an audit but the common law duty is as it is but it is in all respects very much the same as the –

ELIAS CJ:
The common law duty in respect of audit may be overdue for reconsideration.

MR SMITH QC:
It may well be but that of course, as correct as it is –

ELIAS CJ:
Yes, it's not before us.

MR SMITH QC:
Is not before us. And so the question then is if the consequences in terms of breach of a tortuous duty, in terms of causation are pari material with the consequences of this type of breach and it certainly is under the Fair Trading Act, for example, and I will come to that presently.

Then we have to decide whether or not you get in your causation and loss quantification process a complete indemnification judged against what happens in tortuous cases and judged against a statutory regime. Against

tortuous cases and also Fair Trading Act cases and I will just come to those briefly, particularly you certainly don't get a full indemnity. You have to establish that the wrong information that you've been given, that which has been conveyed to you has caused loss and precisely what is the loss that flows from that as opposed to making you whole for everything you did after receipt of it, whether it was related to that information or not. Under the Act you would be supported in coming to that conclusion because the Act is –

ELIAS CJ:

Under this Act, the Securities Act?

MR SMITH QC:

Under the Securities Act. The Act is or was, should I say, prepared to give you a complete utter thorough going indemnity in certain circumstances mainly if there was a void allotment. With a void allotment you got all of your money back. If it hadn't been held in trust, as the directors were required to do then you could reach into the directors' pockets directly if you needed to do that. If it was a voidable allotment then on merely on giving notice which is a simple step to take you get from the issuer all your money back. In the circumstances one would think –

ELIAS CJ:

And you don't have to have any loss?

MR SMITH QC:

You don't have to have any loss but in the circumstances one would think that if that is the type of get of jail free card which was about vouch saved under section 56 then section 56 would have said so but it doesn't. It simply says –

ELIAS CJ:

Well it says you have to have suffered the loss.

MR SMITH QC:

Well it's possible that you get that under section 56 but you have to establish it as a matter of causation and here simply no attempt has been made to do that except by saying, “Let me think.”

ELIAS CJ:

But the query I'm putting to you is whether you only establish that loss by proving that the shares you obtained were worth less than they would have been. I'm not sure how you do that exercise really when you're talking about failure to disclose something. It's not like the valuer’s opinion where you've at least got something to measure it against.

MR SMITH QC:

What you would do is that you would establish, you get a valuer’s opinion just as anybody has to for this type of litigation and putting aside and without getting into the details of who you get and what sort of valuation they would do let's just pick one method and say it's a discounted cash flow valuation. Here you have a change to your free cash flows because, well you might have, because there is a change in the forecast and that might flow through, might, we say it wouldn't have but that's another issue, flow through to that the free cash flows would have been as derived by a valuer using a discounted cash flow method at the time or at or near the time. That is an exercise which a valuer and all valuers do it, are perfectly capable of conducting a year or two or three or even six years later, it's done all the time. And so they would look at whether or not what after all is referred to, with all due respect, by the various accounting expert witnesses as an immaterial deviance from a cash flow forecast and say, “Can we figure out merely by failing to meet a forecast that there is going to be a change, or a material change in the free cash flows which would lead to a discounted value divided for the entire enterprise, divided by the number of shares and the share capital of the enterprise which suggest its worth, for example, five cents less.” If they could do that, well and good, it's what they ought to have done. So I want to come then to the question of how it's approached under the Fair Trading Act and again I don't want to have Your Honour fishing about. I just want –

ELIAS CJ:

Sorry, I'm just thinking about the policy of the legislation in section 37A where value may not be affected at all, the value of your investment in reversing out and wondering whether that is a policy that may affect your measurement of loss also?

O'REGAN J:

But section 37A is only if you knew it was –

ELIAS CJ:

Oh no I understand that and it's only within a year.

O'REGAN J:

No but it's also it's only if you knew it was misleading.

ELIAS CJ:

Yes, yes I suppose that's right.

O'REGAN J:

So it's sort of a culpability –

ELIAS CJ:

Culpability, okay.

MR SMITH QC:

That's the position. Now just for completeness on this question, two cases on the tortious measure just so you have it. It's our volume 2 under tab 17, *Potts v Miller* (1940) 64 CLR 282 which is the High Court of Australia and there is dicta there which relates to the measure of that in these types of case. So it's at page 289 first of all down the bottom, "The measure of damage in cases in which a person is induced by fraud to take up shares is the difference between the amount he subscribed or paid for the shares and the real value, not the market value of the shares on allotment." Nothing turns in that case

between the difference between real and market value because I'm already accepting –

GLAZEBROOK J:
Sorry where are you reading from?

MR SMITH QC:
The last paragraph on page 289. And then over the page, across to page 298 and 299, after the end of the first long paragraph and the citation of *Derry v Peek*, "The reason given for the rule is that after the date of purchase the thing which the plaintiff was induced to buy loses in value owing to accidental and intrinsic causes, that loss is not the reasonable consequence of the inducement. It is not enough to say that but for the representational fraud the purchaser would never have bought and therefore would not have lost the thing bought, to recover back the whole price if the thing had not had any value when bought, he must be in a condition to rescind the bargain and replace it which here the plaintiff is not, as it is not in his power to make the company take back the shares." Exactly the same situation here. "If a man is induced" in the next paragraph, "by misrepresentation to buy an article and while it is still in his possession it becomes destroyed or damaged he can only recover the difference between the value as represented and the real value at the time he bought. He can't add to it any further deterioration which has arisen from some other supervening cause."

And then just in a different milieu it's related if you're looking for a similar approach in another statutory tort or statutory – I'm sorry not statutory tort, I mean statutory wrong Ma'am. *Red Eagle Corporation Ltd v Ellis* [2010] NZSC 20, [2010] 2 NZLR 492 comes to your assistance there and *Red Eagle* is in the bundle of authorities before you at volume 2 and it's tab 20, paragraph 29 and it's referred to, part of that paragraph is referred in the Court of Appeal decision as well but there we have it at 29. That's a case where there was a loan. I think that there was a man called Ellis who had represented to Mr Falkenstein of Red Eagle that his friend or associate Black, who was borrowing money was of a certain worth and it turned out that that

representation that he conveyed was false and so there was a claim against him in misleading and deceptive conduct and then that having been established, the Court looked to the question of damage at 29, “Then with the breach proved and moving to section 43, the relief section, the Court must look to see whether it is proved the claimant has suffered loss or damage by the conduct of the defendant. The language of section 43 has been said to require common law practical or common sense concept of causation.” Without going further the section is materially indistinguishable from section 56. It says “by the conduct of” which is not materially different, I’m very sorry about using that word again, but it’s not different from “by reason of.”

ELIAS CJ:

It’s an indispensible word really isn't it?

MR SMITH QC:

It's at danger of being applied misleadingly which is another issue. “The Court must ask itself first whether the particular claimant was actually misled or deceived by the defendant’s conduct. It does not follow from the fact that a reasonable person would have been misled or deceived, the capacity of the conduct, that the particular claimant was actually misled or deceived. If the Court takes the view usually by drawing an inference that the evidence as a whole that the claimant was indeed misled or deceived,” and I pause to say that's rather a *Broome v Speak* test. “It needs then to ask whether the defendant’s conduct in breach of section 9 was an operating cause of the claimants loss of damage. Put another way, was the defendant’s breach the effective or an effective cause. Justice Richardson in *Goldsbro v Walker* [1993] 1 NZLR 394 (CA) spoke of the need for, or as he put it, “This efficiency of a clear nexus between the conduct and the loss or damage. The impugned conduct in breach of section 9 does not have to be the sole cause but it must be an effective cause not merely something which was in the end immaterial to the suffering of the loss or the damage.” I'm going to go on to just what evidence there was on this subject and I will be longer than 1 o'clock on that.

ELIAS CJ:
We can take the lunch adjournment now. We're on track, aren't we, we don't need to come back early?

MR SMITH QC:
No.

ELIAS CJ:
Thank you, we will take the adjournment until 2.15.

COURT ADJOURNS: 12.58 PM

COURT RESUMES: 2.17 PM

MR SMITH QC:
I wanted to finish this topic by just turning to some of the evidence about loss but before doing so, before the break I mentioned *Red Eagle* and I had wanted to simply observe, for what it's worth, that the approach taken to causation of loss in *Red Eagle* is similar to that taken in the Court of Appeal for the value that has. I'm referring specifically to the decisions referred to in the footnote, footnote 109 to paragraph 97 of our submissions and there are a number of cases there but two in particular are first of all *Cox & Coxon Ltd v Leipst* [1999] 2 NZLR 15 (CA) and secondly *Narayan v Arranmore Developments Ltd* [2011] NZCA 681, (2011) NZCPR 123 and *Cox v Coxon* refers to a similar approach having been taken in relation to the Trade Practices Act 1974 (Cth) in Australia. So these cases are in the authorities bundle and the references are clearly put there.

Now just finally in relation to this topic is the evidence of the approach to loss which was taken as it happens by the respondents or the defendants at trial. There was evidence given by in particular Messrs Cameron, Cornell and Van Zijl. I'm not going to take you to all of it but if I can simply take you to the relevant part of Cameron and Cornell. Firstly, Mr Cameron gave evidence, it's at tab 178 in the consolidated bundle and it's at paragraph 61 to 65. And he

leads up to it in the preceding paragraphs but it's too long a passage to take you through if I start back there. It really starts at 61, "Market price of Feltex if the market closed 23 August is 174, closed on 24 August, which is after an announcement of the financial year '04 results it was $1.70 and on 25 August down to a $1.67, depending whether one focuses on the one or two day period this is a decline of four cents per share or seven cents per share, 2.3 and four percent respectively. In my view in the context of trading Feltex's share this decline can't be assessed as material and cannot be concluded that the sales shortfall was a material contributing factor. I set out my reasons. First, excluding this decline and the movements in the Feltex share price during the three periods of decline identified in paragraph 22 between the IPO and December 2005, Feltex shares experienced average daily volatility of 2.4 per cent and 32 days where there was a price movement of plus or minus four percent." So it's within the margin of error if you were to put in layman's language, I'm sure Mr Cameron wouldn't like my way of putting that. "In this context I do not believe he says it can be concluded that a movement in the Feltex share price of 2.3 or four percent in one or two days material in itself, unless it can be attributable to the company's announcement on the 24th of August or anything contained in that announcement." Next paragraph, "In addition to the underlying market movements other factors may have contributed. Other negative sentiments included the announcement that may have contributed to the fall included Feltex announced a six cents dividend of shares. Well the shares have less, yet to be paid dividend backing, so it's one thing and then secondly, the announcement included the statement that the outlook included a flow down in the residential market in the new housing and apartment segments. Then says in any event he noticed that a similar thing happened to Capital Air Corporation", so he reaches his conclusion in 65.

Just one other thing to say or two other things to say about Mr Cameron, he did give evidence to say that how relevant and useful a market price assessment loss is depends on the efficiency of the New Zealand market and he said that, in his evidence, that the New Zealand market is relatively efficient, namely that it impounds new information relatively quickly. Whether that's subject to differing views or not as the case may be, whether that has

always been the case is another issue but it was accepted for the purposes of trial and he wasn't cross-examined on that.

The second point that I wanted to make about Mr Cameron is if you want to see, I'm not going to go through it because I don't think it's important but in case you were worried that he'd been cross-examined on these things, the passages of his cross-examination which I think are relevant, I'll tell you in a second, but they're really relevant to his view that it was material as opposed to what caused loss and what I'm talking about here is what caused loss. But in case it's of interest they are in the case on appeal, I'll just give you the numbers 4942, 4946, 4947, 4949 and 4951 to 53.

Then the next and final witness on the question of loss is Professor Cornell. You find his evidence in the consolidated bundle at tab 211 and the relevant paragraphs are only two 88 and 89. This may seem not very much in the way of evidence to deal with this issue and you'll recall at trial there was something in the region of 80 allegations of loss causing untrue statements and so not all of them received pages and pages of attention. If you go to his evidence you can see that he's eminently qualified for the task, you see that in his paragraphs 1 and 2 at page 5483 of the bundle. Paragraphs I wanted to take you to are at page 5520 and 5521 where he says, "Feltex met its profitability forecasts and projections for seven months following the IPO, the details of which I discuss in the next section. While the FY2004 revenue was lower than forecast by 7.5 million Feltex accept its forecast EBITDA, net surplus and other bottom line metrics as announced to the market. In 24 August '04 I understand the plaintiff alleges Feltex knew about the likelihood of the alleged revenue shortfall and ought to have disclosed it earlier, however, even if that were true that would not establish that the company share price was artificially inflated as a result. In the circumstances where EBITDA and NPAT and other bottom line metrics were expected to be met and anticipated revenue shortfall would not affect fundamental value and therefore would not result in artificial inflation." And then 89, "On 24th of August Feltex's stock price declined by four cents to close at $1.70 the IPO price. In circumstances there is nothing to suggest the stock price decline was material. The plaintiff has not shown

any artificial inflation existed due to Feltex's 2004 revenue forecast nor has he shown the announcement of a revenue shortfall for 2004 resulted in its removal."

I could take you to van Zijl's evidence but that really trespasses back to the issue of materiality without considering loss and we've been down that path.

The next three issues I hope to go through much more quickly. The next is the issue of represented persons and here we're saying two things. The first is – and this is at page 34 of our submissions, it's section I that I'm talking to, I'm not going to cover everything that's in there but there are two central things. The first is that the test for materiality in my submission is an objective one and the Court of Appeal concluded that even if there was an untrue statement and even if it was materially untrue nevertheless it was not one which was capable of causing loss, that's the view that they came to and that's at paragraph 66 to 73. That is consistent with the view as an objective test in *Broome v Speak* and although my friend, Mr Galbraith, has been to it I just, for this part of my submissions want to emphasise it. You find it in paragraph 67 as a citation in the Court of Appeal judgment where at the end of what Justice Buckley has to say on the subject, that is to say on the subject, that is to say, "It's no use asking people did they, were they really, what was it that motivated them to buy the stock because people can't remember or they make things up." He then goes on to say, "Instead of doing that a test I think to be applied is it has been so stated by Lord Halsbury and also stated in *Smith v Chadwick*; and will be found in many cases that if you find that the matter withheld is such as that if disclosed it reasonably would deter or tend to deter an ordinary prudent investor from applying for the shares then he is entitled to relief and that is an objective test and its subjective conclusion which was reached, although expressed slightly differently in the High Court but certainly in the Court of Appeal.

So it means that on an objective test the concerns which the represented persons, apart from Mr Houghton, the appellant here, have also been answered by dint of the trial and by virtue of the ruling in the Court of Appeal

unless of course you were to conclude that there was a materially untrue statement.

The only way that, of course the extremes always test these propositions, but the only way that you could think that somebody could say that a subjective test would get them back into trial in this case would be, for example, if taking it away from this case, if you had an investor who had made a policy decision that their portfolio wasn't going to include, for example, arms and they invested in an investment company which had an arms portfolio and they were most unhappy about that, they might be able to correctly say, on an objective basis, although their choice is subjective, but they may be able to convincingly say that they would never invested had they known. But even if they get past that test they still have to establish that they suffered loss and if to their unhappiness or otherwise the arms company is continuing to produce profits so that its valuation is not materially different from the valuation at the time that they invested and they have suffered no loss. Whatever remedy they may be able to obtain it's not going to be a monetary loss in compensatory damages. And the next thing I wanted to say about the represented persons is that –

ELIAS CJ:
I wonder whether there's a slightly different way of looking at this, that you could look at it not on the basis of whether the investor would have invested but on the basis that if, and accepting it's material, the consequence would have been that a correction would be required or the offer couldn't go ahead. So in other words I'm just not sure that section 30 – that it would be necessary to take it to the particular investor if that's what you were suggesting.

MR SMITH QC:
No and I suppose in a general way of answering that we have the answer in the evidence which is that if there'd been a correction, however that was achieved, an amendment to the prospectus and the market would have been presented with the very same information it was presented with at the time of the 24 August announcement in which case there was a zero result, on the

face of it what would've happened, it seems a bit of a struggle to invent reasons at this stage why something else would've happened.

ELIAS CJ:
Are you saying that the August announcement was sufficient correction?

MR SMITH QC:
No I'm not saying that, I'm saying that the information which was provided then was the same as the information which would have been provided had the directors thought it necessary to amend the prospectus before allotment.

ELIAS CJ:
Well doesn't that have to be something that would be sufficient correction if there is an untrue statement?

MR SMITH QC:
If there's an untrue statement and we've passed all the other hurdles, I'm merely saying it's worthwhile considering what would have happened had there been an amendment and in the evidence it does seem that we have the answer to that, namely that it would've made precisely no difference. Now I appreciate that at trial the plaintiffs as they were then or the plaintiff could've taken a different approach but that's the evidence that we have and no reason to doubt it at this stage.

ARNOLD J:
I'm not quite sure, I mean are you saying it should've been known the difference objective, I mean the reality is that if there had been a correction at the last moment the float might well not have gone ahead.

MR SMITH QC:
If there had been a correction?

ARNOLD J:
Correction at the last moment it might really have spooked the market.

MR SMITH QC:

Well we don't have any evidence of that. In fact if we – the one thing we do know militates against that speculation, that's the problem that we have which is the 24 August announcement and I might add to that the fact that it continued trading profitably for quite some time after.

KÓS J:

How does that work in practice? The correction is made at the last minute just before allotment.

MR SMITH QC:

Yes.

KÓS J:

So what in fact would happen notionally. The company says, "Whoops Houston small problem, do you all want to reconfirm your investment?" What's the notional discussion that we're considering here?

MR SMITH QC:

I have to admit that I haven't looked through precisely what they do but there is a procedure for dealing with that and it's probably enough for me to say that if you're amending the prospectus then you are doing so because of an adverse event following its distribution that you have found something which is not only untrue but you know it to be untrue and in those circumstances you can't allot the securities in respect of the subscriptions that you have. So there is going to be a delay and it could well be then that people avail themselves of their statutory rights under the section 37 proceedings, you just have to see what actually happens.

KÓS J:

It's a rather more exciting event than a market announcement in August isn't it? I mean you can't assume that the same reaction will apply in each case can you?

MR SMITH QC:

I don't suppose that you can assume anything about any of this but to the – we not having the onus and to the extent that there is external objective evidence telling us what is more likely than not to have happened. The result of the market announcement in 2004, August 2004, is as good a proxy as we will get and it certainly goes the respondent's way not the appellant's way. The second point about that of course is that –

ELIAS CJ:

Can you just don't take time to go to it but give me the reference again to that announcement, just the page number.

MR SMITH QC:

It's referred to in *Cameron* at –

GLAZEBROOK J:

We have the accounts that came out.

MR SMITH QC:

The actual document itself.

ELIAS CJ:

Yes, that's the half yearly.

MR SMITH QC:

That's the year end announcement so 30 June 2004 announcement, the 24th of August and I'm going to ask, he's not my junior but I'm sure he will do it for me.

ELIAS CJ:

Yes later, that's fine, carry on. You were about to say the second point.

MR SMITH QC:

Tab 22, 9385. It's in volume 22 of the consolidated bundle. Volume 22, tab 331.

Now the next thing I just wanted to say about this question of the represented persons and the last thing –

GLAZEBROOK J:
Did you get to your second thing sorry?

MR SMITH QC:
No, this is it.

GLAZEBROOK J:
This is the second thing? I just thought I'd check in case you've –

MR SMITH QC:
No, I feel I've got to the second thing. The second thing is it's not really related to the merits in the evidence here at all but simply to say that the Court of Appeal haven't ruled or not ruled in a way which can be appealed against or sought to be overturned. What the appellant seems to be seeking is some form of gloss interpretation assurance, for example, that they can bring a claim or the represented persons can bring a claim in the High Court to seek damages by dint of the ruling in the Court of Appeal. It's hardly for me to say what's within your statutory jurisdiction but in accordance with the *Independent Fisheries Limited v Minister for Canterbury Earthquake Recovery* [2013] NZSC 35, [2013] 2 NZLR 397 case it seems an unlikely thing for Your Honours, with respect, to conclude that you can do, it's really for the represented people to chance their arm if they want to do that.

ELIAS CJ:
Sorry, I wasn't –

GLAZEBROOK J:
I think we agree with that as we probably indicated.

MR SMITH QC:

The next thing I want to deal with quickly is the question of the Fair Trading Act and the primacy provisions and I will be very quick with that. So the relevant provision is section 24 of the Security Amendment Act 2006 and that's in tab 2 of the appellant's bundle of authorities. It came into effect for relevant purposes on the 24th of October 2006 and the major effect of that amendment is to introduce a set of provisions which related, or new provisions which related to civil remedies including a new regime for pecuniary penalities and compensation.

GLAZEBROOK J:
Can you just let me find it, I'm just buried.

ELIAS CJ:
Which amendment is it?

MR SMITH QC:
The 2006 amendment under tab 2.

ELIAS CJ:
Yes, thank you.

MR SMITH QC:
And you will recall that at this time there was a change to the Securities Act where no doubt the legislator felt that the pre-existing civil compensation regime was a little clunky and needed overhauling and so what is now brought into the Securities Act is the section 57B et seq and I don't need to go into that in detail just to set the context which is to say this is the regime whereby the notion of the Securities Commission, later the FMA could obtain a declaration of a civil liability event and having done that then any person who was an investor could ride on the coat tails of the civil liability event declaration and simply seek damages without having to prove liability. There was also provision for pecuniary penalty orders as well. But amongst all that, obviously Parliament thought since it was in the process of revamping the Act, it decided to act on what I suspect had been a concern for some time that there was

overlap between the Fair Trading Act and the Securities Act which simply oughtn't to exist and so we have section 14 of the Securities Amendment Act which is the first of the new provisions, general provisions on liability in the Amendment Act and it introduces into the Security a new section 63A. It says, "A Court hearing a proceeding brought against a person under the Fair Trading Act must not find that person liable for conduct that is regulated by this Act if that person would not be liable for that conduct under this Act." So it makes as soon as you're suing somebody under the Fair Trading Act in respect of a securities matter, whether the claim is brought under the Securities Act or not, you have to make an enquiry as to whether they would be liable. If they are liable, that's the end of it, if they're not liable under the Securities Act then it's the end of any Fair Trading Act claim as well.

So in the trial this was the subject of some argument and the provisions were referred to then as I'll refer to them as now the primacy provisions. Just pause to note that a similar provision to like effect was put in the Fair Trading Act under section 5A. So the appellant in trial sued –

ELIAS CJ:
It's really a commensurability provision isn't it?

MR SMITH QC:
Yes.

ELIAS CJ:
So you can go under either Act but the effect has to be the same.

MR SMITH QC:
Yes that's right, that's right. Well there's no doubt what the effect was, the question at trial and appeal and now if we have to look at it, is purely the question of retrospectivity. Is it retrospective, when did it take effect? The events we're discussing took place in early 2004, whereas the primacy provisions came into effect in October 2006. In the High Court, Justice Dobson upheld our submissions at his paragraph 629 and said that

the provisions did bite and the Court of Appeal, the majority disagreed with him and those passages are from 292 to 295. On the other hand Justice France's minority view, which is at 296 was that section 63A did apply and the appellant was precluded from relying, sorry the respondents were – sorry at section 63A, indeed the appellant was precluded from relying on the FTA.

In terms of the reasoning and what we say is wrong, is that the majority in the Court of Appeal was saying, at the passages I've given that because there is the spectre if you like of removal of rights retrospectively then there is the possibility of unfairness and because there is a possibility of unfairness via the removal of rights one looks for strong statutory language to see that that indeed was Parliament's intention, not to suggest that Parliament couldn't have done it.

On the other hand Justice Dobson in the High Court saw the matter in similar terms to Justice France in the Court of Appeal, both felt that there was no unfairness that was obvious because of the fact that whilst rights under the FTA were possibly retrospectively being removed, on the other hand it wasn't as if they were being removed wholesale because what was being left in place was a parallel set of rights which in many respects was the same. So in the absence of a wholesale retrospective removal of rights, the Judge in the High Court and Justice France in the Court of Appeal weren't as motivated to look for (inaudible 14:45:05) statutory language to achieve that result. We say that Justice Dobson and Justice France with respect were right and on the question of fairness, Justice Dobson's dicta at paragraph 628 will be of assistance to you as you go through it but particularly I wanted to take you to something which is referred to in our submissions but in slightly more detail which is an article in the Centre for Commercial Resources Law, it's in our bundle, it's in the respondent's bundle of authorities, item 50. That's in the electronic bundle. It's under tab 50, it is an article by Michael Gillooly called "Misleading or Deceptive Conduct under Section 995 of the Corporations Law*",* from Colin Lockhart (ed) *Misleading or Deceptive Conduct: Issues and Trends* (The Federation Press, Sydney, 1996)

GLAZEBROOK J:

Well I have no idea where this is.

MR SMITH QC:

Do you have on the flash drive an electronic –

GLAZEBROOK J:

I've no idea, I just seem to have a –

O'REGAN J:

Yes I've got it, it's at the respondent's authorities at tab 50.

MR SMITH QC:

I wonder if I can – can I simply just –

GLAZEBROOK J:

Well if it was going to be referred to it would've been nice to have it in hardcopy.

MR SMITH QC:

Yes I'm very sorry I simply hadn't realised the difficulties that were going to be encountered with electronic bundles but Ma'am I do –

GLAZEBROOK J:

We asked for hardcopies of what was going to be referred to.

MR SMITH QC:

I do apologise, it does occur sometimes. We do have hardcopies. I think we can assist with a hardcopy Ma'am. So this is an article which – well the relevant passage begins at page 70 under the heading "Defences to prospectus liability" and before going into detail, what the author is talking about and concerned about is the lex specialis issue where you have a special regime, a general regime such as he refers to partly here, intellectual property and the Fair Trading Act but also he mentions more specifically later on corporations law as it relate to securities issues and again the Fair Trading

Act and at page 70 he says, “It’s long been the policy of Anglo Australian companies legislation that those involved in issuing defective prospectuses should not be liable for false statements contained therein unless they’ve acted dishonestly or unreasonably.” And then over the page, page 72, last paragraph, “The highly interesting question that of course arises is where does this leave the Trade Practices Act section 52 and the action for damages under section 82, it seems clear that the issue of defective prospectus will normally constitute a breach of section 52 and yet surrender the contravener and those knowingly involved liable to damages under section 82 but section 82 is not expressed to be subject to the due diligence defence. Does this mean that a plaintiff applicant can deprive a defendant respondent of the due diligence defence simply by suing under the Trade Practices Act rather than the corporations law.”

Then he goes on to deal with how this sort of issue earlier emerged in Australia in the well known fair trading case being *Parkdale Custom Built Furniture v Puxu* (1982) 149 CLR 191 and that was a case, where as you see under the heading, “Side wind argument,” on page 74 where Justice Brennan had an issue where there was the failure of a person who owned the design to register the design under the Designs Act and therefore obtain a statutory monopoly. There had been a clear line of authority to say that in that event as a matter of law the design was up for grabs by anybody but then along came the Fair Trading Act and it was argued that it was actionable under the Fair Trading Act, and putting aside what the answer to the problem was, it was a view that Mr Justice Brennan disagreed with. So in New Zealand we have –

ELIAS CJ:

Can you just tell me because I'm confused now, I can't remember. Is the only materiality of the different regimes in this case the application of the defence?

MR SMITH QC:

I don't know if it's the only one, it's the one I wanted to focus on.

ELIAS CJ:

Are there other material differences?

MR SMITH QC:

It's pretty difficult to see, you can't rule them out but it's difficult to see how misleading and deceptive under section 9 is going to be that much different from untrue statement given the statutory definition in section 55 of the Securities Act. So you can't all knowingly rule out that being a problem.

ELIAS CJ:

Yes.

MR SMITH QC:

But I can't see it at the moment.

ELIAS CJ:

Yes, I'm just trying to think of the scope, the effect of the argument that you're making to us.

MR SMITH QC:

The issue is the defences and under the defences, putting aside what was the position in the Trade Practices Act and the corporations law in Australia. In New Zealand just to outline very quickly what the problem or potential problem is is that in New Zealand the due diligence defence entitles a director, for instance, or a promoter to rely, for instance, on the assistance of a servant or agent which could include an employee or it could in this case relevantly include Ernst & Young, could include Minters, Bell Gully, nothing unusual about that whereas under the Fair Trading Act section 44 the defence is expressly excluded the entitlement to rely on any servant or agent whether the agent is internal or external. So there is potentially a very material difference between the two, and I don't think I need to take you to the two sections to put them side by side. You can see that from an instantaneous reading of the two of them side by side, section 43 of the Fair Trading Act and section 56(3)(c) of the Securities Act.

So what that really means is that if there is a question of unfairness about the removal or co-existence of the two regimes together the issue of unfairness sounds in the co-existence of the two regimes rather than the removal of the ability to sue under the Fair Trading Act where you can proceed under the Securities Act. So for that reason, in my submission, Justices Dobson and France were right and the majority in the Court of Appeal were wrong. Whether that sounds in any result in this case I don't know but there we are.

The last thing that I wanted to talk about was the due diligence defence and where we are on that is that in the High Court at paragraph 52 the Judge held that the due diligence defence was made out but he said that it may need to be reargued.

ELIAS CJ:
Sorry, in the Fair Trading Act, however, I'm just trying to think of what the real unfairness is. It is personal liability not liability by virtue of office, is it? I can see that that's a point of difference with the Securities Act if that's right.

MR SMITH QC:
Well it's a personal liability if it's a director.

ELIAS CJ:
Yes.

MR SMITH QC:
Personal liability if you're an individual issuer.

ELIAS CJ:
So the person has to have made the misleading or deceptive representation or conducted themselves.

MR SMITH QC:
Well it could be the promoter, for example.

ELIAS CJ:

But I'm just trying to see the extent of the overlap. I can see that the amendment is very sound because it makes it equivalent but there may be reasons why you wouldn't exclude liability under the Securities Act – the Securities Act is directed at the people who are liable by virtue of holding office which is why you would have a due diligence defence.

MR SMITH QC:

Yes, that's right but equally under – I think the real difference is that under the, if we step back, under the Securities Act when you have a public issuing there's a statutory and regulatory requirement to provide a lot of information and it all has to be right.

ELIAS CJ:

Yes.

MR SMITH QC:

Whereas under the Fair Trading Act there simply isn't any obligation at all.

ELIAS CJ:

Yes.

MR SMITH QC:

So under the Securities Act because there is an obligation to produce an enormous amount of information the defences are, relatively speaking, more available and more forgiving as there is quite a profound difference between the statutory purposes or legislative purposes.

ELIAS CJ:

Yes, I don't think I'm disagreeing with you and I think that's sufficient because, as you say, it may not trouble us in the end.

MR SMITH QC:

So lastly and perhaps I won't take more than five minutes at the most. Anyway due diligence in the High Court, paragraph 52, it was made out according to Justice Dobson in his judgment but he said it may need re-argument depending on the nature of the misleading content or omissions and the circumstances in which the content appeared in or was omitted from the prospectus. He commented on due diligence at 534 and said that it was a very thoroughly designed due diligence, conformed to the best practice by independent expert evidence which was led on the subject. And then in the High Court at paragraphs 5 –

GLAZEBROOK J:

So you mean the High Court?

MR SMITH QC:

The High Court.

GLAZEBROOK J:

It's still High Court.

MR SMITH QC:

544 through to 546, he goes through the detail of what was involved in due diligence and then 547 to 549 he deals with the reply and in 549 really he says that the reply is valid only in the abstract, in other words, the only reply which is really given was to say that if due diligence was nothing more than a triumph of form over substance than it wasn't going to amount to anything which Justice Dobson accepted but he just simply said that the problem is that it wasn't a triumph of form over substance and it was a very wholeheartedly and carefully designed regime.

Then in section 550 he goes on to say, “However, I wouldn't be persuaded that there was any sense in which the thoroughness of the process was a charade or that those who were attributed individual responsibilities to verify accuracy of the content in any way shirk their responsibilities or fail to apply

themselves with appropriate care. If Mr Forbes' argument in this regard was intended to go so far as to suggest some mutual unspoken recognition that a thorough process could disguise an absence of genuine individual assessment of the accuracy of the content then his case did not go anywhere near laying a foundation for a challenge to the due diligence process as being less than genuine."

Then 551 he goes on again to really, having heard the evidence, provide what might be called a judicial endorsement of the satisfactoriness of the regime. The same with 552, the same with 554. And then in the Court of Appeal, their way of describing it appears at paragraph 213 and there the judgment says, "We observe however that our review of the evidence suggest a due diligence process which was thorough in both its conception and execution. The evidence we have seen suggests the process was engaged in wholeheartedly and with a clear understanding of its purpose by the members of the DDC, the due diligence committee and those they interviewed" et cetera, et cetera.

The respondents contend that the judgment in the High Court and the Court of Appeal can be upheld on due diligence grounds. The provision requires reasonable grounds for belief that a statement was true and again what we're saying is that first of all the respondents contend that the sales forecast for 2004 was a forecast not capable of being untrue. In that case the due diligence defence isn't needed. Alternatively materiality is a prerequisite for an untrue statement in the sense the act intends untrue statement or alternatively again if that's not right then no relief can possibly flow from an untrue statement which is immaterial and we say at either of those points, B or C, an honest belief in the lack of materiality of a statement equates with honest believe in its truth, only untrue statements that are material are to be considered. So in other words when we consider the concept of –

GLAZEBROOK J:

If they're honest but unreasonable belief in the lack of materiality, what do you say?

MR SMITH QC:

The reason why, if we look at the question of truth, you see its counterpart – truth as it's used in section 56(3)(c) of the Securities Act which is the due diligence defence, you see it's counterpart as a true or untrue statement in section 55. So in section 55, if you're dealing with a case of omission which this is a case of omission, the omission has to be material.

GLAZEBROOK J:

Sorry I'm assuming you've lost on material in respect of this, so it was material because you don't even get to the due diligence defence.

MR SMITH QC:

Correct, entirely.

GLAZEBROOK J:

Unless it was material, so let's assume it is and without making any comment on whether that it is the case.

MR SMITH QC:

No I am assuming that we've got to that point.

GLAZEBROOK J:

So we've got a material untruth.

MR SMITH QC:

We've got a material untruth and then my question is whether or not the due diligence defence extends to an honest belief that a statement which you know to be untrue is nevertheless material. In other words does that amount to due diligence? There is an argument to say that it might and the argument is that when you consider the word "truth" in section 56(3)(c), that is the equivalent concept of the word "true" or "untrue" as the case may be in section 55.

GLAZEBROOK J:

It's probably better if we make sure we've got it in front of us. Well it certainly would be better for me.

MR SMITH QC:

It's in the respondent's first bundle under tab 1. So if we go first to section 56(3)(c), "As regards every untrue statement not purporting to be made on the authority of an expert or a public official, document or statement, he or she had reasonable grounds to believe and did up to the time of the subscription for the securities, believe that the statement was true." So if we go back then to section 55 which defines an untrue statement.

GLAZEBROOK J:

But don't you still have to be reasonable?

MR SMITH QC:

Sorry reasonableness is always a requirement.

GLAZEBROOK J:

So it's an objective test, you had to have had reasonable grounds to believe it was true.

MR SMITH QC:

Oh it's an objective test, yes absolutely.

GLAZEBROOK J:

And if it's not true in a material way you can't have had reasonable grounds to believe it was.

MR SMITH QC:

Well yes you could, with respect, if it's not true as a matter of fact, then there could well have been information which you were entitled to rely upon and did so, not only honestly but reasonably because you had no reason to believe that there was anything wrong with it, that's not the issue here.

GLAZEBROOK J:

No, I totally understand that, I didn't think that was your submission though.

MR SMITH QC:

No and what my submission here is that we've got a statement, it is, objectively speaking, untrue. Never mind about objective or material or anything else it's just untrue. And, in addition, we know its untrue but we have –

GLAZEBROOK J:

You had reasonable grounds for thinking it was immaterial, is that – I totally understand.

MR SMITH QC:

And the question is whether or not reasonable grounds to believe that the statement was immaterial is sufficient to give rise to the defence and the argument that it is, I'm almost there, whether you agree with it or not is another issue, is that you equate truth in section 56(3)(c) with untrue in section 55, the definition section, and in particular section 55(a)(2) because we're talking about omissions, and for an omission to be untrue it has to be misleading by reason of the omission of a particular which is material and if you truly believe and –

ARNOLD J:

No, material to the statement and that was my point yesterday.

MR SMITH QC:

Material to the statement.

ARNOLD J:

“Material to” generally means relevant. So what that reads is, “Which is relevant to the statement. For myself I don't accept that that reference to materiality introduced materiality in the sense of significance in the way that its used elsewhere in the Act.

MR SMITH QC:

Well I won't –

GLAZEBROOK J:

I don't even think you need to get there, you're being too complicated.

ARNOLD J:

Yes.

GLAZEBROOK J:

If you look at (c), if you had reasonable grounds to believe it wasn't material then you had reasonable grounds to believe it wasn't true assuming that materiality is a necessity in terms of the statement but by the time we get to this we've got to have assumed that.

MR SMITH QC:

But the better approach may be overall to say that if you thought that there was an untrue statement and that it was material and that it needed to go back to the High Court then it would be appropriate for you to observe that the issue of due diligence and section 63 relief and the Securities Act and the defences under the Fair Trading Act if the Fair Trading Act applies at all, are live issues, simply that.

GLAZEBROOK J:

Well you may want us to say also that if they had reasonable grounds to believe it was immaterial then the defence would be made out as well, that would be even better for you.

MR SMITH QC:

I would rather like you to say that.

ELIAS CJ:

I would need to have you explain again why that is the correct interpretation.

MR SMITH QC:

Well it's because of the correspondence between section 56(3) which uses the concept of truth, reasonable belief in truth. So we look at the word “truth” in its statutory setting as opposed to its popular meaning and its statutory setting we find section 55(1)(b) which says that a statement may be untrue if it is omission by reason – if I we just get the actual provision – by reason of an omission of a particular which is material to the statement in the form and context in which its included.

So if the particular is the shortfall on sales and we say, well we know that that is a shortfall. There is a shortfall, we all know that there’s a shortfall but we don't believe that it is material. If materiality is a prerequisite for an untrue statement under section 55(a)(2) which it is in the case of an omission –

ELIAS CJ:

Okay, I understand where the issue is.

MR SMITH QC:

Then indeed the argument is that you don't have an untrue statement because it is sufficient that you believed honestly and on reasonable grounds that it wasn't material albeit that you knew that the statement wasn't true. So that's the argument. Now unless I can be of – a bit longer than 45 minutes, I'm sorry.

ELIAS CJ:

Yes thank you Mr Smith. Yes Mr McLellan, is your time estimate still 45 minutes? It’s fine if it is.

MR MCLELLAN QC:

I would think so.

ELIAS CJ:

Yes I think we’ll take an adjournment at 3.30 and sit on thank you.

MR MCLELLAN QC:

Your Honours the JLMs adopt the submissions for first and third respondents on all matters but say that in any event in relation to the Securities Act causes of action the JLMs cannot be liable because they are not promoters. The promoter of this offer was the named promoter, namely the second respondent and the JLMs did not consciously become promoters by their conduct which I will go into.

Just to revisit the interpretation section, that's set out at paragraph 5 of my written submissions and I say that the JLMs don't come within section A as a promoter and they are in any event, they were in any event a person acting or persons acting solely in their professional capacity.

I just want to start with the High Court judgment which is tab 43 and the relevant section of the judgment starts at paragraph 558 and if we go a few pages into that to 580, by this point His Honour has discussed the legislative history and the common law which I will come back to briefly presently but the key part of the decision in terms of the test that His Honour reached at paragraph, it's at paragraph 580 where His Honour said that, "I consider that the wording of the definition contemplates both a relatively close measure of personal involvement and a level of authority enabling any promoter to have or at least to share a measure of control over decisions as to the form and the terms on which the offer of securities is made. Those who participate at the direction of others are likely not to be instrumental in formulating the plan for the IPO if their advice on material points of the plan can be rejected by the vendor or the issuer." And I respectfully submit that that remains an accurate statement of the position and I also respectively say that the minority decision in the Court of Appeal of the President Justice Ellen France also accurately reflects the position and I'll come to the majority's decision in a moment.

And if we go down to 581, echoing that first thought in 580, His Honour went on to say that, "Examples of the JLMs' suggestion as to the content of the prospectus or conduct of the IPO being adopted don't assist the plaintiff because significantly in all respects their involvement was limited to making

recommendations and they always had to take instructions from Credit Suisse and Feltex. Some of the JLMs' recommendations were rejected."

And again at 583, "The JLMs did not share the power to make relevant decisions, at least in the circumstances of this IPO I consider that it is an important factor in taking them outside the contemplation of the primary element of the definition of promoter, namely those who were instrumental." And I'll come back to those words when I talk about the Court of Appeal's decision because in my submission the key words in section 2 are instrumental in the formulation of the plan or programme. And as the authorities made clear, the question of whether a person is a promoter is very much a factual issue and so I will come back and discuss some of the evidence that's been given in the High Court relevant to that.

The Court of Appeal's decision which is tab 44 and the relevant section there starts at 214 and if I can take Your Honours to 255 as being the key part of the test. So at 255 we begin with the statutory language, "The existence of the definition makes it plain that a person may be a promoter even though they're not named as such." And then the last sentence of that paragraph, "We accept the JLMs' argument that the continued use of the common law concept of the promoter through the legislative history of the section suggests an intention to carry forward the common law concept of what a promoter is. So I'll come back to some of that common law, particularly the 19th century cases in a moment.

And then at 256, "We consider that in this context therefore a promoter is one who brings a plan into existence by taking an active part in forming the plan pursuant to which the shares are offered to the public through the distribution of a prospectus. We also proceed on the basis that the promoter must have been party to the preparation of the prospectus. And in my submission that test of taking an active part in forming the plan, I say is a watering down of the keywords in section 2, namely "instrumental in the formulation of a plan" but I'll come back to that.

264 is the majority's conclusion applying the Court's test to the facts and there the Court said that, "The majority considered that the nature of the role played by the JLMs brought them within the definition of promoter in A because they were actively involved in the formulation of the plan to offer securities. The JLMs worked as part of a group that developed the plan and were a means by which it was implemented. The critical commercial role they played in the offer meant they were able to shape aspects of the offer even if they did not have decision making power." And I'll come back to this when I talk about in particular the terms of the mandate letter pursuant to which they were engaged and the activities that they actually conducted but I immediately emphasise the Court's use of the words, "They were part of a group that developed the plan and were a means by which it was implemented" because it's central to the JLMs' submission that there is a contrast in section 2 between the conception of a plan pursuant to which an offer is made, which I say is what section 2 is about and the implementation or execution of that plan and in my submission the JLMs were implementing Credit Suisse's and Feltex's plan, they didn't formulate it, they didn't conceive it.

And then the minority reasoning is set out at 265 and 266 and really the substance of that is at 265. Her Honour considered that the JLMs do not fall within the definition because their role was to assist with the offer and that is my submission also.

So I'm just going to look at some of the commentary on promoter law and in the respondents' bundle in volume 2, you will find extracts from *Morrison's Companies and Securities Law*, tab 25 and if we just go to the second page which is 4.2 "Liability of promoters at common law". "At common law promoters owe a fiduciary duty to the company once it is incorporated. This means that their relationship to the company is very similar to that of a director. In fact, the creation of a rule rendering promoters liable at common law was designed to fill the gap which existed because a person could behave in the same way as a director of a company before its incorporation."

And then a few pages in we go to chapter 8 which has a useful section at 8.2 on the common law definition of “promoter.” “At common law the term "promoter" does not have a very definite meaning. It is a flexible term referring to those who directly or indirectly arrange or participate in the incorporation of a company, other than those acting in a purely professional or ministerial capacity. Those who take decisive steps to shape and limit the company may be called promoters.”

KÓS J:

Bit of a difference between the two sentences, isn't there? “Those who directly or indirectly arrange or participate,” and then the second sentence elevates them to a decisive role.

MR McLELLAN QC:

Yes and in the cases involving incorporation of companies the language that's used in some of those cases such as in the footnotes to 8.2 you will see references to the *Wheal Ellen Gold Mining Co (No Liability) v Read* (1908) 7 CLR 34 at 43 decision at footnote 8 and onwards, and that is an early decision of the High Court of Australia where that language was used but in my submission those cases are relatively straight forward cases which involve persons incorporating a company who are not directors, have no intention of being directors and in those cases they are, as I say, fairly straight forward as opposed to the more complex cases I will take you to in a moment such as the *Emma Silver Mining Co Limited v Lewis & Son* (1879) 4 CPD 396 which involves slightly more nuanced arrangements.

ELIAS CJ:

Promoters of companies may be one thing but presumably you're taking us onto authorities in relation to promoters of securities?

MR McLELLAN QC:

The majority of the cases involve start-up companies as they did in the 19th century so as we will see from the three cases I'm about to take you to,

they involve the mixture of incorporation and floating of an offer to raise capital from the public.

So I won't spend too long on those because they are summarised in my written submissions but in the 19th century, late last half of the 19th century there was a spate of unscrupulous conduct by people who were described as promoters and who I say are the appropriate proxies for the term "promoter" still and they are summarised at page 5 of my submissions and the first of these was the *Erlanger v New Sombrero Phosphate Co* (1873) 3 App Cas 1218 which involved Baron Erlanger who put together a structure of a company in order to raise vast sums for the New Sombrero Phosphate Company, the facts –

GLAZEBROOK J:
Which should have been a clue.

MR McLELLAN QC:
It was all about guano, and he, for example, got the Lord Mayor of London as a patsy director. He was effectively a puppeteer of the five directors and he manipulated them to do the things that he needed to do to incorporate the company but there are three quite useful statements which I will take you to if I may. This is in volume 1 of the respondent's bundle at tab 12. Firstly at page 1268 the judgment of Lord Blackburn in the last three paragraphs His Lordship started talking about promoters and the Companies Act 1862 (UK) and of course there was no investor protection in the statutes in the 19th century, so the effect of these cases was to essentially declare that people were promoters, it's not a legal term but it's a shorthand for those who are held to have fiduciary duties to the company because that was the gap that needed to be filled. So in the last paragraph, "Neither does the Companies Act 1862 impose any duty on these promoters, it gives them an almost unlimited power to make the corporation subject to such regulations as they please and to create it with a managing body whom they select, having powers such as they choose to give to these managers." And over the page, "And I think those who accept and use such extensive powers which so

greatly affect the interests of the corporation when it comes into being are not entitled to disregard the interests of the corporation altogether." Then a few lines down, "Consequently they do stand with regard to that corporation when formed in what is commonly called a fiduciary relation to some extent."

And if we just go back in the judgment to the judgment of Lord Selborne at 1260 and I won't take you all the way through it but about six lines down is the relevant passage setting the relationships of the five directors and then down towards the end of that long paragraph, "There was in fact no independent purchaser, no bargain, the vendors themselves managed the whole thing and they made those who through their means undertook a trust for others their passive instruments." And I come back to that when we're looking at the facts of this case that this is the opposite that the JLMs were, if you want to describe it in that way, the instruments or the independent contractors of Credit Suisse and Feltex, they advised, they recommended but their advice was not necessarily followed and ultimately it was Credit Suisse and Feltex who controlled the terms of the offer and whether for example it closed.

And then the final paragraph or the final section from that judgment is that of Lord Cairns, the Lord Chancellor at 1236 and if you can just note the section that starts about eight lines into the second paragraph, "They have in their hands the creation and moulding of the company."

The other two decisions that are referred to in my written submissions are the *Twycross v Grant* (1877) 2 CPD 469 case which is again summarised at page of my submissions and the *Emma Silver Mining* case which is at tab 11. I don't need to take you to either of those cases, other than to say that in the Court of Appeal's judgment the Court referred to *Emma Silver Mining* as being a case that didn't involve a decision making power on the part of the promoters and that is, in my respectful submission, an oversimplification of what is required to be a promoter because a promoter, while analogous to a director or an issuer, is a promoter not because of a formal appointment, they are held to be promoters because they don't have a formal appointment, they don't have liability as a result of contract or statute and so the common law

has filled that gap by holding that they are promoters because they are part of an arrangement. All these three cases, particularly *Emma Silver Mining*, are cases involving effectively joint enterprises whereby the unscrupulous puppeteer has entered into an arrangement with the others whereby a company will be formed, that money will change hands. *Emma Silver Mining* has fascinating facts which involve the brokers who were ultimately held to be promoters, arranging with the others to put up a company and they would be paid a small commission on ore but they would be compensated by a payment of 5000 guineas which was a secret commission in effect and in return for that they would effectively agree to lie to potential investors about the prospects of the mine and so contrary to the Court of Appeal's view of that case, it is in fact very much on all fours with the reasons why the Courts have held promoters to be such.

So I refer to those cases really to give some colour to the current provision because as both Justice Dobson and the Court of Appeal held, Parliament can be taken to have been intended to take through section 2 some of the common law from particularly the 19th century cases.

ELIAS CJ:
Perhaps you could just tell us which topics are you going to address following this?

MR MCLELLAN QC:
I'm going to leave the statutory scheme for you to read in the submissions given the time.

ELIAS CJ:
We have read your submissions.

MR MCLELLAN QC:
And I am going to deal with the professional capacity provision in C and then I'd like to spend most of my time on the facts of this case.

COURT ADJOURNS: 3.32 PM

COURT RESUMES: 3.50 PM

MR McLELLAN QC:

Before I move off that *Emma Silver Mining* case can I just give you the reference where the Court of Appeal referred to that which is 247 of the Court of Appeal's judgment and they described *Emma* as being, "An instance of defendant's being held liable as promoters who did not have decision making power," and the submission I've just made is that, indeed, they do have de facto control over the structure of the company or the offer.

At paragraph 19 of my submissions I refer to section – well firstly at paragraph 17, of course section 56 imposes liability on promoters in exactly the same way as it does on directors and so that is some, in my submission, interpretative assistance or provide some interpretative assistance as to what was intended by Parliament as to who is captured as a promoter. Similarly, at paragraph 19, section 58, imposed criminal liability in respect of a prospectus that includes an untrue statement on every person who signed the prospectus. Promoters are of course obliged to sign the prospectus, so again an indication that promoters are largely, if not identically, treated with directors and issuers.

So that's what I want to say about the first limb of the definition of promoter and dealing with the professional capacity provision in subsection (c), my written submissions deal with that from paragraph 25 and I have provided you with the history of the statutory exception which goes back, as I have set out at paragraph 27 and as Justice Dobson accepted, that to the 19th century decision of *Re the Great Wheal Polgooth Co Limited* (1883) 53 LJ Ch 42 which provided a common law exception for professional advisors and that found its way through the legislative history to the 1978 Act.

At 34, paragraph 33 onwards, I've provided you with various authorities and texts on the meaning of "professional". Now I might have been overdoing that in the written submissions but you will recall that the Court of Appeal said that the professional exception wasn't fully argued in the Court below and so I

have provided you with some depth of authority on professionals and the authorities which I've cited, they come from a range of subject matters such as tax, insurance and company law. I don't intend to take you to those because I think that they stand for the relatively straight forward proposition that certainly in contemporary legislative interpretation and in particular the section that we are dealing with, "professional" needs to be interpreted relatively broadly and perhaps at paragraph 36 there is a reasonably adequate interpretation of it there from *Carr v Inland Revenue Commissioners* [1994] 2 All ER 163 (CA), "before one can say that a man is carrying on a profession, one must see that he has some special skill or ability, or some special qualifications derived from training or experience". And as I will come back to there, isn't in my submission, any real doubt that the JLMs were professionals for the purpose of the exception to section 2.

At paragraph 43 I provide you with a reference to Darvell and Clarke's *Securities Law in New Zealand* which is at tab 26 in volume 2 of the respondent's bundle and I don't need to take you to that because I have provided you with the entire quotation there which is, "It is submitted that an underwriting or stockbroking firm managing a floatation or issue on a normal retainer basis will be within para C but if the firm is itself responsible for initiating the float or receives remuneration more akin to a profit on a venture and normal professional charges, the exemption will probably not apply."

So that takes me to the facts of this case and I want to start this section by taking you to the mandate letter which is –

ELIAS CJ:
So you accept that formulation do you, so that if they're taking a share of profit or more than normal professional charges it's more debatable?

MR MCLELLAN QC:
It's more debatable if they are sharing in the profit making nature of the scheme as opposed to taking standard fees and the evidence in this case is that the JLMs fees were standard for New Zealand IPOs of this nature.

The mandate letter is in the consolidated bundle and I'm sorry I can't give you the volume but it's at tab 320 and that starts at page 9158 and if we start on the first page you'll see half way through the first paragraph that the JLMs were retained to provide investment banking and broking services, that's just half way through that paragraph on the terms and conditions described herein. Under the heading of "Investment banking services", "The JLMs will assist the issuers in defining a structure for both the listing and the offering that satisfies the issuers requirements, conforms to applicable legal and regulatory requirements and is acceptable to investors."

And then over the page, I won't take you through all of these provisions but there are so many saying effectively the same thing. So starting at (i) near the top of the page, "Advise and assist in connection with listing, advise the issuers on…"

GLAZEBROOK J:
Sorry I don't – oh I've got it, so that's fine.

MR MCLELLAN QC:
"(ii) advise the issuers on any matters required to be addressed to complete the listing." And then if you cast your eye down through 1 to 9, assist, assist, advise and assist et cetera. I think Justice Arnold went to this earlier in the hearing, this section of the mandate letter. And then at the bottom of the page, "JLM shall perform all the services in accordance with generally accepted professional standards and good business practice with promptness and diligence and in accordance with all applicable laws and regulations." And that in my submission is simply consistent with the obligations which the JLMs have pursuant to the NZX listing rules which I don't need to take you to but the relevant parts are at tab 28, section 8 which obligates market participants and advisers to observe proper ethical standards and act with honesty, integrity, fairness, due skill and care and diligence and efficiency. In other words indicia of professional activity.

Then on page 3 of the letter under due diligence, “The JLMs will assist the issuers with the due diligence process, attend meetings as observers.” Next paragraph, “They will participate in the due diligence process as observers, take all reasonable steps to ensure that information given to the DD committee is accurate and correct but will not be liable to the issuers. The JLMs will provide a confirmation in the form contained in the due diligence planning memorandum.”

The firm allocation section, I don’t need to take you through that because I think there's been discussion about the obligation on the JLMs to take firm allocations. The evidence is that the JLMs took $80 million in firm allocations and other brokers took allocations of another $60 million.

ARNOLD J:
Does that include the effect of underwrite of the bond holder’s option?

MR McLELLAN QC:
That was in addition to that. So the total bonds at the start of the offer process were $60 million and the obligation was to take out the difference between what the bond holders accepted in the priority offer and the enhanced priority offer and in the end I think that was $46 million in bonds were taken up so there was a shortfall of about 14 million, so two JLMs shared that shortfall.

ARNOLD J:
So is the last paragraph on this page correct in that arrangement or is it dealt with somewhere else?

MR McLELLAN QC:
Yes it is. You'll see four lines up the bonds shortfall obligation and they are paid a fee but you will see that –

ARNOLD J:

I mean was the evidence about that, is that, I mean I know that brokers take firm allocations, that's usual enough, but this is a sort of underwriting, a different sort of underwriting arrangement.

MR McLELLAN QC:

It is not an underwrite in the pure sense that it would be called an underwrite but it has a similar effect to that which I think the evidence was that that was itself a fairly standard term for an IPO.

ARNOLD J:

So it raises an interesting question, I guess, because if arrangements of that sort become common on the part of brokers so that it does give them a reasonably high degree of skin in the game, if I could use that term, and therefore increases the incentives to shape an offering in a particular way it seems to me sort of slightly odd really that you can say, well the profession has effectively defined its own exclusion by what is commonly done, do you see what I mean? There's a sort of policy issue in there, it seems to me, that the idea of promoters is supposed to address some concerns and I'm not saying this is true in this case but it may be that the professional exclusion thing if one approached it too loosely would undermine the sort of policy underlying the liabilities created from promoters.

MR McLELLAN QC:

Well I'd answer that by saying not on the facts of this case because the evidence doesn't show that the JLMs had any controlling, or as Justice Dobson put it, a measure of control over the final terms of the offer. So even if they had these obligations to take allocations of shares and to sell them it didn't alter the substance of the arrangements between the issuer and Credit Suisse and the JLMs.

GLAZEBROOK J:

Although that's an argument that they don't, they are not a promoter at all, isn't it, rather than that they are acting in a professional capacity?

MR McLELLAN QC:

Yes, that's right, and as I've said in my written submissions, there's a relationship between A and C and in my submission you read them together in order to understand what A is about because they both draw on the common law, yet my primary submission was that they don't come within A at all but A is covered by C.

ELIAS CJ:

I would have thought C actually was an exception to both A and B the way its structured but you just say they reconcile.

MR McLELLAN QC:

I've described C as a belts and braces provision.

ELIAS CJ:

Yes.

MR McLELLAN QC:

On the facts of this case I say it doesn't matter, they are not within A but even if they are or if you say in interpreting A you have to look at C, they're not a promoter.

Over the page are the fees and expenses that the JLMs were to be paid and, again, the evidence was that these were standard fees for an IPO of this nature. They were paid brokerage on the firm allocation that they took but then so were the other brokers who took firm allocations. So in my submission that doesn't take them out of the ordinary role of a professional broker.

Page 5, there was an incentive fee arrangement but that was in the absolute discretion of the vendor. Their expenses were reimbursed, that's in the third paragraph. Fourth paragraph similarly, "The JLMs would consult together about the placement of print advertising, they had a budget for that. The

company would reimburse the vendor for advertising expenses incurred on their behalf by the JLMs."

Over the page on page 6 you'll see a heading "conditions precedent", "So the launch and closing of the offer contemplated here and the JLMs' obligations in respect of the offer were subject to the satisfaction of the following conditions precedent and they are for example due diligence, satisfactory completion of all regulatory requirements." And then in the next paragraph, "Please note that (a) the issuers must rely on the expertise of their specialist legal accounting, tax, public relations advisors and (b) the issuers will remain solely responsible for the underlying business decisions, proceed with the listing and the offering." So that's telling the JLMs it's ultimately our decision whether this goes ahead because the JLMs are dependent for the majority of the fees for the offer closing. They do have an entitlement to a much lesser termination fee if it didn't but the JLMs had no right to control whether it did close.

Under the heading, "Provision of information and confidentiality", towards the end of that paragraph, "It being understood the JLMs will rely solely on such information supplied by the vendor and the company and their respective representatives without assuming responsibility for independent verification and do not assume responsibility for the accuracy, correctness or completeness of the information."

Now I just don't have it to hand the other clause that I wanted to refer to somewhere in here and I will find it, is that there is an acknowledgement that the – it's at page 7 in the third and fourth paragraphs down which are acknowledgements that the JLMs may have conflicts of interest and each JLM undertakes to maintain appropriate Chinese Wall arrangements which again is consistent with the obligations under the listing rules. So I refer to that conflict provision because that came up I think in Justice Arnold's exchange with counsel for the appellant during this hearing.

I just want to now go through some of the key roles that the JLMs had, quite apart from the specific terms of the mandate letter. Can I just give you a

reference to one of the briefs of evidence of the joint lead managers and that's Ross Mear who was Forsyth Barr's principal investment banker who was involved in this and that's at tab 227. I don't need to take you to that but what I'm about to say is drawn largely from that brief and I've given you that brief reference because it's a fairly clear set of the evidence of the JLMs as to what they did in the offer and I just want to run through some of those key things now. Some of these are set out in the written submissions but I'll just deal with it quickly orally.

So they did, of course, draft parts of the prospectus. Mr Mear says there was nothing novel about this particular structure. The parts that they drafted then went to others such as Credit Suisse, Feltex's management and other professionals such as the lawyers and the accountants advising on the offer.

Initial advice was given by each of the JLMs. Forsyth Barr, for example, recommended an instalment receipt procedure whereby the investors would pay a certain amount now and a certain amount later. Credit Suisse and Feltex rejected the advice. First NZ Capital recommended that Credit Suisse retain the minority stake in the company and sell that down in due course and again Credit Suisse, because of its preference to have a complete sell down, rejected that advice. So the evidence was very clear that Credit Suisse and Feltex were responsible for the conception and formulation of the offer.

The joint lead managers gave advice on valuation of the company and on price and they initially advised a range of $1.65 to $1.95. Credit Suisse considered that $1.70 to $1.95 was where they wanted to put it. Mr Mear says in his evidence that the JLMs advised Credit Suisse that they should see the price of $1.65 as a target not an expectation. Credit Suisse's expectation was, however, at that slightly higher price range. And after the book build, the process by which the shares, the price was fixed, the joint lead managers recommended a price of $1.60 to $1.65 and Credit Suisse fixed the price at $1.70.

On the dividend about which there was quite considerable evidence at trial, the joint lead managers made recommendations on dividend. The funding of an increased dividend was debated between the JLMs and Credit Suisse and Feltex and the JLMs considered that the appropriate way to go about this was to fund the increased dividend by increased debt but Credit Suisse and Feltex decided that increasing the size of the initial offer was their preference and so that's what happened and some of that evidence is summarised at paragraph 66 of my written submissions.

There is one final factual point that I want to come to and this refers to the lock-up of shares which the Court of Appeal referred to at paragraph 264 of the judgment and this is the paragraph I read to you earlier on where the Court talks about the critical commercial role that the JLMs played in being able to shape aspects of the offer, so the evidence that I've taken you to in my submission shows that they weren't able to shape aspects of the offer, they were able to advise on and make recommendations on aspects of the offer but only Credit Suisse and Feltex had the ability to shape those aspects.

The Court saw as evidence of this the lock-up of shares. The lock-up of shares is one element of the equity incentive plan and the Court said that although the objections made by me as to poor process in advancing this aspect of the appellant's case are noted but the role the JLMs played in agreeing the lockup of shares of directors is recorded in the prospectus. So just for completeness I want to take you to that and the prospectus which is tab 321 and the page reference is internal page 59 or SC9232. And you'll see in the right-hand column the heading "Director's shareholdings" and, "The condition on the closing of the offer a minimum of shares will be acquired through associates. These non-executive directors have been participants in a long-term equity incentive plan with the vendor." So the JLMs had nothing to do with the long-term incentive plan but the JLMs recommended that the directors agree that their shares will be or that 50 per cent of their shares will be locked up for 12 months, sorry 75 per cent will be locked up for 12 months before they could dispose of the shares for the fairly obvious reason that that

would provide the market with confidence that the directors weren't wanting to sell their shares.

The evidence on this doesn't support the Court of Appeal's observations in paragraph 264 of the appellant's submissions. There was evidence in emails between Mr Thomas and other directors that he was certainly strongly recommended to them that they agree to a lockup of shares against some opposition from some of them and he said something along the lines that the JLMs require it. Now that wasn't put to the – put in those terms to any of the JLMs but Mr Hamilton who was a First NZ Capital, one of the investment bankers from First NZ, the reference to his evidence is at tab 226 and I can probably just read it to you, it's page 5860, SC5860 and this email from Mr Thomas was put to Mr Hamilton and he was asked, Mr Hamilton was asked, "In this email it's clear that there is a problem with the directors and management and their option scheme, isn't it?" Answer, "I wouldn't quite characterise it like that, I'd say there's a difference of view between ourselves and obviously Mr Thomas and perhaps Feltex or perhaps Credit Suisse and Feltex Board around the level of retained shareholding that management would have after the IPO." "Well what was your knowledge as to the requirement was in terms of the option agreement with the managers and the directors as to holding the shares after an IPO at that stage?" "Look I can't recall specifically, my understanding or from what I do recall was that there was no requirement for those managers or board members to retain any shares as part of the option agreement, obviously if there was no restriction that I can recall in the option agreement for them to retain their shares after they had been issued." And question, "And you're advising and recommending strongly I suggest that it's essential to the IPO that the directors and managers retain a percentage of their shareholding." Mr Hamilton replied, "Yes that was our strong advice at the time." So again the Court of Appeal's observations on this point isn't matched by the evidence at trial. This is just another example of the JLMs giving, in this instance strong advice which was accepted by Credit Suisse but in other instances advice was not accepted.

I just want to make two brief comments about other issues which are the due diligence defence so if the JLMs are promoters then they are entitled to a due diligence defence in the same way that the directors are. That's set out at paragraph 71 of my written submissions and at paragraph 73 I refer to the due diligence committee with appropriate professional personnel on it, Rob Cameron, an expert in investment banking, gave independent advice that the evidence that the due diligence process was in accordance with best practice. The joint lead managers were of course observers on the committee. At paragraph 75 I refer to the negative assurances that they gave to the due diligence committee, that to the best of your knowledge nothing had come to their attention during their attendance at meetings that prevented them responsibly from giving the confirmation and making the statements in the due diligence report.

And similarly in relation to the bring down due diligence meeting on the 2nd of June. Firstly, the point I make specifically in relation to the JLMs there, there's no pleaded allegation that the JLMs knew that the sales revenue forecast wouldn't be met or that they did not believe or have reasonable grounds to believe that the forecast for FY04 was true nor was it put to any of the JLMs witnesses in cross-examination that the shortfall was material or that it rendered the information in the offer document untrue.

And then the final point is in relation to the Fair Trading Act. A slightly different point for the JLMs which is that they weren't responsible – the offer document was not issued by the JLMs and notwithstanding that the appellant did not contend in his pleadings or submissions in the High Court the JLMs were liable as secondary parties to the statements made by Feltex, its directors and Credit Suisse in the offer document, and I refer at paragraph 80 to the *Body Corporate 202254 v Taylor* [2009] 2 NZLR 17 (CA) decision in support of the proposition that if the appellant had wanted to argue that the JLMs had liability as secondary parties he would have been required to plead and prove that they acted with knowledge that the conduct they were assisting was misleading but when the appellant filed his third amended statement of claim, third and then fourth amended statement of claim he withdrew an

earlier pleading of secondary liability after being required to plead particulars. Unless Your Honours have any questions those are my submissions.

ELIAS CJ:
No, thank you Mr McLellan.

MR CARRUTHERS QC:
May it please Your Honours. May I begin with the interpretation of section 56 and deal with my learned friend Mr Smith's issue. My submission remains that the absolute prohibition is in section 33, that no offer may be made unless it complies with the regulations, the Act and the regulations. This prospectus did not because of its untrue statement that leads through to section 56 which provides the remedy where there is a prospectus with an untrue statement, it provides a civil remedy.

Well I want to deal with the words "by reason of" and the way in which they have been interpreted, at least at the Court of Appeal level in the context of securities legislation and under the Securities Markets Act 1988 which was a Securities Amendment Act that was renamed, the expression "by reason of" is used in the definition of an insider and I'm going to the respondents' electronic bundle of authorities. I'm not sure whether Your Honours saw the exchange but I was asking Mr Smith where the hardcopy authorities were in his bundle to find that they're only available electronically but I can deal with it.

The starting point is case number 26 in the respondents' bundle and it is a case of *Haylock v Patek* [2009] 1 NZLR 351 (HC).

GLAZEBROOK J:
Is that one we do have or not?

MR CARRUTHERS QC:
No I don't think you will have it Your Honour because, well put it this way I haven't got it in my respondents' bundle.

ELIAS CJ:

It's in the respondents' authorities and it's number?

MR CARRUTHERS QC:

26.

ELIAS CJ:

Yes I have that.

GLAZEBROOK J:

Mine doesn't have numbers which is really useful.

MR CARRUTHERS QC:

In the index?

GLAZEBROOK J:

No.

ELIAS CJ:

I can forward this perhaps to you, I will try.

MR CARRUTHERS QC:

The reason I'm going to the High Court judgment is just to get you the statutory provision because it doesn't appear in the Court of Appeal decision but you'll see at paragraph 24 of the High Court decision that insider means a person who by reason of being a principal officer et cetera and that provision was interpreted in the High Court but I'll go to the Court of Appeal decision and I'll simply have to give you the electronic reference. In the electronic reference it is 26(b) in the respondents' authorities and the relevant paragraph is 205 and I'll just read it to you, "We do not think it necessary to engage in any detailed analysis of the term 'by reason of' in the context of the present case. We are content to adopt the straightforward approach that the phrase may be equated with because of or by virtue of. We are also satisfied that it does not matter whether the inside information is received by a principal

officer of the public issuer in more than one capacity. While there may be cases where it may be possible in the particular factual circumstances to clearly differentiate between the possession or receipt of information by a principal officer in one capacity or another, this was clearly not such a case."

So when I opened the appeal I used the expression "as a result of" as being equivalent of "by reason of" and I want to go through my analysis of the argument. I may have misunderstood an exchange between Your Honours Justice O'Regan and Kós but I thought I was understanding you to say that my argument didn't recognise "by reason of" but my argument does and let me just put it quite quickly.

ARNOLD J:
I don't think I did say that but anyway.

MR CARRUTHERS QC:
Well I apologise, Your Honour, if I have misunderstood one of the exchanges, but the way in which the argument runs is that the prospectus had an untrue statement. It should not have been offered with the untrue statement. Mr Houghton would not have invested had he known of the untrue statement. His loss, therefore, is the amount of his subscription. Now what I then did was translate that into section 56 I dealt with on the faith of by taking you to the evidence. And then the analysis that I made was this, that the loss that he sustained was by reason of, that is, as a result of, because of, or by virtue of the untrue statement and the connection is that the untrue statement is in the prospectus but still the loss is by reason of that untrue statement and the way in which his loss is measured is that the offer should not have been made with the untrue statement in it and in those circumstances the loss is properly reflected by the inability to invest apart altogether from the evidence that he wouldn't have, and that the amount of the loss is the subscription. So the argument does embrace by reason of.

Now the second topic I want to deal with is directors' knowledge and this goes to my learned friend Mr Galbraith's analysis of the documents and with

respect to him, his analysis goes off on a completely irrelevant basis and a basis that is not sustained by the evidence that was actually given. The documents relied on in the argument I made, that is the April and May commentaries, are merely a record of the facts as they were at the end of April and the end of May 2004. The issue is not when the directors received those documents, the issue is what information they had available to them and the answer is that they had information at the end of the month in the way in which Mr Tolan and Mr Magill explained and let me take you to the evidence. I will deal first with Mr Tolan, that's volume 149, the reference is 9/3685 and I'm at paragraph 39.

ARNOLD J:
Sorry, I was a bit slow on catching up.

MR CARRUTHERS QC:
Sorry.

ELIAS CJ:
You've given us the electronic reference, have you?

MR CARRUTHERS QC:
Well I'm hoping that in –

GLAZEBROOK J:
149, which brief of evidence?

MR CARRUTHERS QC:
149, and the page number is 3685 and I'm going to read paragraph 39. So in paragraph 39, “As I have already said, the 2004 forecast was based on actual figures until the end of March 2004 and forecast figures for the final three months of the financial year. The forecast was substantially completed by 8 April 2004 but we continued to make minor changes to it during April. The final version was completed by 30 April 2004.” And then he says, “I’m aware that the plaintiff says that the figures should’ve been updated to take account

of available information from trading in April. I do not believe this is correct. I would have received daily and weekly figures throughout April 2004 as we did every month and by the end of April I will have had reasonably accurate sales figures for the full month of April but we not have all the other financial figures for the month such as costs, rebates, et cetera, to allow us to produce an accurate monthly trading report. The financial model used to produce the forecast requires all of those figures and it's not possible to recalculate one month's figures simply on the basis of sales data. We could not therefore have calculated profit or EBITDA for April without those figures and so could not update the model and forecast. It was a major task every month to produce the monthly trading report for inclusion in the monthly group operating report and that would not normally be completed until about the tenth working day of the following month."

Now I want to go from there to the cross-examination which is in 153 at page 3788. The last question on 3787, I don't need you to go there but it just says, "What about the sales reports, who got the sales reports?" And then on 3788 the answers comes through, "The sales report".

ELIAS CJ:
We'll get it but we have to scroll.

MR CARRUTHERS QC:
Can I read from 3788?

ELIAS CJ:
Yes.

MR CARRUTHERS QC:
"The sales reports were generated each morning and they were emailed only internally to the chief executive officer, Sam Magill, and the other general managers and some other sales people who were, for example, the sales manager for residential commercial, they would be on the distribution list too. So a variety of sales people." I'll go to the answer, "Mr Magill, myself, the

other general managers and some senior sales people and then for example the group financial controller, she'll be on a distribution list too." "Now did you have margin figures in those sales reports?" "There were indicative margin figures, not necessarily actual margin figures." "What do you mean by indicative margin figures?" "Well Feltex operated a standard costing system so each product had a standard cost. Standard costs are set based on various assumptions at a time when you prepare those standard costs. The actual costs, once they come through you have a difference between your standard margin and your actual margin, so that's why I say they were an approximation of the margin for the products." "So those are, I think they're called COGS, aren't they, cost of goods sold, so it's abbreviated as COGS, and so the margin we can call that a gross margin figure, can we call it that, that's in the sales reports that you get, is that a fair way of describing it?" "Different people describe it in a different way. Some people call it gross margins, some people might call it gross contribution, some people might call it net margin before freight, it depends on the organisation." "Well what was it called in Feltex?" "I think we just labelled it as margin." So that's Mr Tolan's evidence concerning receipt of the reports and what happened. So daily and weekly, the sales and margin information.

Now I'll go to Mr Magill who was cross-examined and that's in volume 160 or tab 160 and volume 10 at 4241. This was a discussion about the group operating report for the month of May and at the top of 4241 the Court asked the question, "Right my question is when do these, how early in the following month do papers of this type come to the Board?" "Well it takes – it took Des Tolan, you know, I think he mentioned a timeframe but they had to do all the company results for the month and then once we had the financial results completed and we had all the general manager's reports in and the sales managers, then this could be compiled and Mr Tolan virtually I think indicated that he was responsible for making sure that all the documentation came up to him and his people put it together after, you know, I'd had a look at it Sir." "So the May numbers in the commentary would they have been available before or after the allotment of the shares or do you not know?" "The allotment of the

shares was June the 2nd, so the report, well this has been presented at the 22nd of June, so it would be after the allotment of shares Sir."

Now then what is taken up is when the information actually became available and this deals with May. "But you and Mr Tolan received daily sales reports?" "We did Sir, we did." "So at the time of the 2nd of June due diligence bring down, due diligence meeting, you would've had the figures for May, the sales, the sales for that month." "Yes well we would have. The sale we anticipated would be then, you know, these documents Sir." "So would those, would that information include volume and revenue figures?" "Yes it included volume, revenue and I believe margin Sir." "And budget?" "And budget Sir." "Could the witness be shown the volume schedule." Well I probably don't need to go any further than that.

So what in fact was available on a daily and a weekly basis and certainly at month end in preparation for the compilation of the group operating reports was volume, sales, margin, budget. Now my submission is that the obligation of the directors in relation to the 5th of May and the 2nd of June was to ascertain the position particularly because of the significance of those events. Really to do otherwise is to frankly be asleep at the wheel. And I've been dealing with what the directors had access to and similarly the information in the commentaries was factual information that accumulates over the course of the month and is available at month end.

The position put by my learned friend really just doesn't bear analysis because of the nature of the obligation under the legislation and it's a point that's picked up in *Hickman v Turner and Waverley Limited* [2012] NZSC 72 in paragraph 151 where the Court said, "Section 37 of the Securities Act is designed to protect investors when offers of security are made to the public. The Act is designed to ameliorate that vulnerability. It is appropriate to bring that purpose to bear on the question whether constructive knowledge should suffice in the circumstances we are addressing. In my view it would not be consistent with the purpose of the Act to allow someone who did not actually know, but should have known of, the relevant facts to escape the

consequences of being sufficiently implicated in a tainted transaction." So the information was available and the directors had an obligation to understand the correct position as at 5 May and at 2 June.

The next topic I want to deal with is trends. My submission is this that the pattern of trading up to April/May is the relevant inquiry. A year to year comparison of the kind made by my learned friend says nothing about the trading conditions leading up to April and May. And at all events the inquiry has to focus on April and May and the position at the beginning of June and that focus has to be on the 20 per cent shortfall in each of April and May against both budget and forecast an evaluation of its significance.
The significance is also this: the background was that April had been missed and the expectation that that would be made up in May and that was wrong also. So my submission is that the analysis that my learned friend made of trends really is not a helpful or relevant analysis.

The next topic I want to deal with is margin. My learned friend's analysis of margin is in relation to carpet sales and my submission is it's not a relevant analysis. Your Honour Justice O'Regan, I'm picking up an observation that you made when you were shown the monthly reports and picked up the difference between the margin at the top of the page and the margin after overheads and I'm just dealing with that point. So my submission is that the analysis which my learned friend Ms Mills made of margin is a correct analysis because it involves taking into account the overheads and the reason for the correctness of that analysis is that carbon margin dollars do not drive either EBITDA or NPAT. One needs to take into account the overheads till EBITDA and then expenses to get down to NPAT. And that's why those tables are constructed in that way and that's why my learned friend's analysis and critique of the Court of Appeal's paragraph 107 is correct and if I can just make some observations on the issue of margin and why the way in which my learned friend has dealt with it is really not a proper analysis of the impact of margin and if I can take you to 6406, it's 240, 6406. Now that's the report for April 2004 and you'll see under the cost of sales the figure of 5966 as actual cost of sales against a budgeted cost, let's just take budget for the moment of

21,899 and that's how you get to the margin of 34.2. Now the question is why is that margin higher than budget or forecast and the reason is that the cost of sales was significantly lower because there was less carpet available.

Now you see the same pattern with the reports for May and that's at tab 243 and the page number is 6911. It's the equivalent table from April, this is the May table and you'll see the impact of a lesser cost of sales on margin there and then when you get to June which is 244 at 7082, you have a significantly higher cost of sales. So what I have done really to just help on that issue of the proper way of looking at comparative margins is to just produce a table with the percentage figures and this drives from my learned friend Mr Galbraith's additional bundle.

KÓS J:
But aren't those increased costs of sales driven by the increased volume sold? I mean they're not independent.

MR CARRUTHERS QC:
No, no they're not independent. Under tab 1 in my learned friend Mr Galbraith's additional documents there were three pages of analysis and the third page is, "Margin is more important than sales," and his centre column deals with margin for the fourth quarter and deals with it as a gross margin. What this table does is really deal with the way in which it should in fact be recorded after overheads and then I've given the document references and taken the figures from his table and then picked up the way in which my learned friend, Ms Mills, analysed it.

O'REGAN J:
Was there any evidence about what was the appropriate way of calibrating margin and what was meant by the statement, Feltex's statement that it was improving margins? Because I mean we're now just faced with one counsel saying this is the right one and the other one saying that's the right one but how do we know?

MR CARRUTHERS QC:

Is that told in cross-examination.

ELIAS CJ:

That we were taken to?

MR CARRUTHERS QC:

No, I've got another passage that I'm taking you to in relation to margins.

O'REGAN J:

That's fine, if you're coming to it that's fine.

MR CARRUTHERS QC:

There's an extensive passage of cross-examination of Mr Tolan that deals with margins forecast and the creation of PFI.

KÓS J:

It's around about 3790 I think.

MR CARRUTHERS QC:

There's a reference to margin. I know there's an extensive discussion about it and Your Honours are right in that page reference. There's a specific reference to it at 3888 going onto 3889 where Mr Tolan is being taken through the way in which those monthly reports are being compiled. I think the only issue, in answer to Your Honour Justice O'Regan, is that margin is used in different ways and It's an issue of what you take into account in the sense of what you're really trying to understand as to what's happening to the business but the logic of the argument that's being put is that in order to understand what's happening to a business, you need to understand overheads and you need to understand expenses and not simply your costs of sales. I think that's the only point that arises out of that analysis that I've made.

In that passage of Mr Tolan's that I've just taken you to at 3884 going on to 3885, he deals there with that – in cross-examination he was in fact

cross-examined on the impact of the calendar error and records there that it had an impact on, a significant impact on what happened in the month of April and carrying through into May. I think the point was made, I think by my learned friend Mr Weston, as to whether there was cross-examination on calenderisation as he resisted calling it and that's the passage that arises. Your Honours I'm nearly there, I'm going as quickly as I can.

ELIAS CJ:
No don't worry.

MR CARRUTHERS QC:
I've got three very short topics to do. Extended credit, Your Honour Justice Kós made a point of commenting that the respondent had said this wasn't raised in the Court of Appeal. I've gone back to my notes of the oral argument and it was plainly raised and argued and reference is given to material that I'm going to take you to in a moment.

ELIAS CJ:
In the Court of Appeal?

MR CARRUTHERS QC:
Yes in the Court of Appeal, yes and as was explained, the relevant footnote can only have arisen in response to argument. Now I don't – I hold to the submissions made by my learned friend Ms Mills on extended credit, that they really derive from the Tolan presentation on 8 April 2004 that you were taken to. There's a recognition by Mr Cameron that this was a separate and new initiative and it's not at all, as my learned friend Mr Galbraith put it, that this was just business as usual and let me just take you to two references that illustrate the point. I'll go to 243 which is volume 17 at 6923 and that's part of the group operating report and you'll see under the heading –

ELIAS CJ:
We don't have it. Oh 6923, yes. So sorry what's this part of?

MR CARRUTHERS QC:
It's part of the group operating report and it's a commentary on the balance sheet. It's the May report.

ELIAS CJ:
Yes.

MR CARRUTHERS QC:
And you'll see under, “Receivables, trade account receivables increased by 10.1 million following a lower than budgeted collection ratio,” and it gives the ratio, “due to extended terms offered and leading to higher days outstanding,” and that's the 10 million figure that my learned friend took you to in some of the evidence.

The other reference to extended credit that I want to take you to is at 330 which is volume 22 at 9380. It's in –

ELIAS CJ:
Volume 4, is it? So what are –

MR CARRUTHERS QC:
These are the minutes of the audit and risk management committee.

ELIAS CJ:
What electronic volume?

O’REGAN J:
Seventeen.

ELIAS CJ:
How did you know that? You're very good.

MR CARRUTHERS QC:
No, I'm in 330 and it's 22/9380.

KÓS J:

Yes, it's 17.

ELIAS CJ:

Seventeen, okay.

KÓS J:

It's the first one in 17.

ELIAS CJ:

Remind me again the page?

MR CARRUTHERS QC:

I was on 17 which was the group operating report, I'm now on 22 at 9380 which is the minutes of the audit and risk management committee and this is at 22 June 2004 and these are a series of bullet points and if you come down the page to Mr Horrocks, "Mr Horrocks noted." And I will read it, "Mr Horrocks noted that there had been an extension in credit terms-

GLAZEBROOK J:

9380 is it, sorry?

O'REGAN J:

Yes.

ELIAS CJ:

Is it in 17?

O'REGAN J:

It's the very first one in 17, it's tab 330, it's the minutes of that meeting.

ELIAS CJ:

I've got one that goes to 6846, I don't understand. Anyway, read it.

O'REGAN J:

Just look for 330, just scroll down 330 and it's the second page.

KÓS J:

I just emailed it to you.

ELIAS CJ:

Have you, thank you.

MR CARRUTHERS QC:

And if I come up from the bottom of the page and it's the third or the fourth and third bullet points. "Mr Horrocks noted that there had been an extension in credit terms, which resulted in higher receivable balances at the end of June 2004 and that this was probably material enough to warrant some additional audit procedures on the major debtors." And then, "Mr Tolan noted that the extended terms related to programs such as the Stainmaster program and initiatives that were designed to secure a higher portion of customer business (eg from 55 per cent to 65-70 per cent)." That's just additional factual information to add to the submissions that were made to you on extended credit terms.

GLAZEBROOK J:

If the extended credit was designed to increase sales and did increase sales then it's of little significance, isn't it, unless they were possibly bad debts by doing that, because you're not bringing forward revenue that you would otherwise have got but getting paid later and if that's the case it's only the time value of money of the month or so that you are waiting for your money, although it could artificially up sales in a particular month although it didn't do a very good job of that in April and May it has to be said.

MR CARRUTHERS QC:

No that's right but judging from the 8 April presentation it looks as if it was being implemented but I think the point that Mr Horrocks is making is that by June the extended credit terms were biting in the sense that this is one of the

methods by which the June figures are looking good in the sense that they're recorded as sales for June and there's extended credit that is simply adding to the receivables.

The next topic I want to deal with is the JLMs as promoters and I necessarily have to deal with this rather more quickly. The first submission I make is that I support the decision of the majority in the Court of Appeal that as a matter of definition the JLMs were promoters under subparagraph A and I draw attention to the word “programme” because it’s not simply “plan”, it’s “plan or programme” and my submission is that the scope of the work that the JLMs had to do as set out in the mandate brings them within that definition and that the majority in the Court of Appeal was right.

Now the issue about professionalism under C is this, my submission is that a broker’s professional role based on the evidence that was given, is that they advised clients concerning share portfolios or investment. They act for clients really as an intermediary on a buying or selling share basis but what happened in this case, which was not solely professional, is this, that the JLMs underwrote the bond conversion. I use “underwrite” in the sense that it’s been referred to in the course of the case and I understand my learned friend Mr McLellan’s point that it’s not strictly an underwrite and I agree with what he says on that but for convenience it’s referred to as an underwrite. But by taking that obligation under the bond conversion, what the JLMs were taking then was a personal commercial risk. They were not acting solely in a professional capacity. The process of selling shares in terms of the obligation that they’d taken on under the underwrite was to protect their personal commercial exposure, their conduct was, just in this respect, was not solely professional and so that takes them away from the exception and leaves them as promoters under subparagraph A.

KÓS J:

Would that mean a solicitor acting on a contingency basis would no longer be a professional? I mean a measure of commercial risk is not inconsistent with professionalism.

MR CARRUTHERS QC:

Well you raise an issue that is a little fraught now because there are situations where an element of contingency is allowed. So I think one would almost get to the point of saying that that is a recognised aspect of professionalism but I understand the –

ELIAS CJ:

Well I suppose it's done under a professional umbrella.

MR CARRUTHERS QC:

Well I understand the sort of example Your Honour is trying to draw and one can see situations in a solicitor's practice where a course of conduct would take him or her outside acting solely as a professional and with the JLMs there are plainly many elements in the mandate that are within their professional capacity but the point is that they have to be acting solely in that capacity and in this respect their interest is not solely professional, their interest is a commercial, personal, protective mechanism. Due diligence

O'REGAN J:

In the mandate there it talks about them acting as investment bankers rather than – and investment bankers and brokers, do you say it's only the broking part that's professional and not the investment banking?

MR CARRUTHERS QC:

Oh no, no I couldn't say that. I mean I think that in a modern context one would have to regard the legislation as referring to skilled activities of that kind but certainly whether one looks at the underwrite as being broking or investment banking, it wasn't solely professional, that's the argument.

Finally I want to get to just deal with the due diligence defence and I think there are just two submissions that I need to make on that and I rely on the judgment of the Court of Appeal and the paragraphs I rely on are 209 which follows the appellants argument in 208 where the Court said, "We agree that the section 53(3) defence is not by its very terms available to those who know

a statement is untrue but fail to correct or withdraw it because they believe it to be immaterial. Section 56(3) only provides a defence to those who believed at the relevant time that the statement was true and had reasonable grounds for that believe. If the defendant knew the statement to be untrue but wrongly considered it immaterial then section 56(3) has no application. A defendant cannot escape liability if he or she knew a statement to be untrue, even if the defendant had reasonable grounds to believe it immaterial." Now with respect I adopt that and then at 212, "The appellant's point is well made that when considering the defence it is important to focus upon the substance of what a defendant knew and the steps they took to satisfy themselves as to the truth of a particular statement. We also accept the submission that a due diligence process, however sophisticated and perfect in conception may not suffice unless it is rigorously applied to the content of the prospectus and with a proper understanding of and focus upon the purpose of the process."

And the only other passage that I want to refer to is that at paragraph in *Hickman* again concerning knowledge which bears on the due diligence defence in the same way as it bears on the director's obligation to make enquiry and that's the passage I cited from para –

ELIAS CJ:
Whose judgment was that from because it said "I" when you read it out? Was that Tipping J was it?

MR CARRUTHERS QC:
That was Justice Tipping's judgment, yes it was, yes. And Your Honours those are my submissions in reply and I apologise for the time.

ELIAS CJ:
No, no you were admirably succinct. Thank you counsel for your submissions, we will reserve our decision in this matter. We will retire.

COURT ADJOURNS: 5.19 PM